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CORPORATE, SECURITIES AND EXECUTIVE COMPENSATION LAW ALERT

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Dodd-Frank Provisions Relating to Corporate Governance, Executive Compensation and Disclosure

On July 15, 2010, the U.S. Senate passed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") and President Obama signed the bill into law on July 21. The sweeping law will have significant effects across the financial services industry and will impact not only financial services companies, but also all U.S. consumers and most U.S. companies, private and public. While many of the substantive changes included in the legislation will be left to regulatory agencies for implementation, and although the legislation mandates studies over the next several months and beyond by various regulatory agencies with regard to many areas covered by the bill, Dodd-Frank will affect our clients' financing and business decisions immediately. The full text of Dodd-Frank can be accessed here.

In this client alert we are focusing on changes affecting corporate governance, executive compensation, public company disclosures, whistleblower protections and investor standards. Several of our colleagues are preparing client alerts on portions of the bill relating to their specific areas of practice. These client alerts, and other materials prepared in the coming months related to Dodd-Frank, will be posted here as they are published.

Under Dodd-Frank shareholders of U.S. public companies will have a nonbinding "say on pay" vote for named executive officers, new standards relating to the independence of compensation committees and compensation advisors are mandated, current and former executive officers may be forced to return compensation if a restatement of financial statements triggers a "clawback", brokers' ability to vote shares for which they do not receive instructions will be further limited, proxy disclosures will be enhanced, the Securities and Exchange Commission ("SEC") is granted express authority to enact shareholder access to the company proxy, smaller reporting companies and non-accelerated filers will be relieved from providing auditor attestation of the effectiveness of internal controls and procedures, whistleblower protections are expanded and the definition of "accredited investor" will be updated. The majority of these items are subject to additional rulemaking by the SEC which will likely impact companies beginning with 2011 annual meetings and proxy statements.

Shareholder Say on Pay Vote; Frequency; Golden Parachute

Section 951 of Dodd-Frank amends Section 14A of the Securities Exchange Act of 1934 (the "Exchange Act") to require a non-binding vote of shareholders no less frequently than once every three years to approve the compensation of a public company's named executive officers – this is the so-called "say on pay" resolution discussed in press accounts of Dodd-Frank. Additionally, Dodd-Frank requires a public company to include a resolution no less frequently than every six years for a non-binding shareholder vote to determine whether the say on pay vote described in the prior sentence should take place every one, two or three years. Dodd-Frank requires the first of each of these non-binding resolutions to be included in the proxy for the first annual or other shareholder meeting occurring after the date that is six months after the enactment of Dodd-Frank. That means that companies holding a shareholder meeting after **January 21, 2011**, will need to include these resolutions.

Additional Resources

Read more at:
http://www.orrick.com/doddfrank

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In addition to the say on pay vote with respect to the compensation of the named executive officers, Section 951 of Dodd-Frank separately requires disclosure (the contours of which are to be determined by SEC rulemaking) of the terms of "golden parachute" payments to named executive officers in connection with an acquisition, merger, consolidation of an public company or a proposed sale of all or substantially all of the assets of an such public company. The disclosure must be contained in the consent solicitation or proxy in which shareholders are being asked to approve the acquisition, merger, consolidation of the company or a proposed sale of all or substantially all of the assets of the company in any meeting occurring on or after **January 21, 2011** (six months after the enactment of Dodd-Frank). The referenced proxy or consent solicitation must include a resolution for a non-binding shareholder vote to approve the golden parachute payments, unless such payments (or the agreements or understandings documenting the payments) have already been subject to a say on pay vote as described in the prior paragraph.

Additionally, Section 951 of Dodd-Frank authorizes the SEC to exempt, by rule or order, an issuer or class of issuer from all of the say on pay requirements described above and the section specifically orders the SEC to consider a disproportionate effect that the requirements may have on small issuers.

Finally, all institutional investment managers (such as the managers of most mutual funds) that are subject to Section 13f of the Exchange Act must report at least annually how they voted on any of the say on pay-related votes described above.

The combination of the new say on pay resolutions and the further limits on broker discretionary voting, described below, will further strengthen the influence of proxy advisory firms such as Institutional Shareholder Services and Glass Lewis as they issue voting recommendations.

What to do: Public companies should begin to prepare to include these resolutions for any meetings occurring after **January 21, 2011**. In addition, extra care and attention should be devoted to drafting compelling arguments for executive compensation arrangements (including a full description of parachute payments) in the Compensation Discussion and Analysis in the proxy that accompanies the first say on pay vote.

Independence of Compensation Committee and Compensation Advisors

Section 952 of Dodd-Frank requires the SEC to act to require national securities exchanges and national securities associations to enact listing standards that prohibit the listing of equity securities for any issuer that does not have an independent compensation committee under the standards set forth in Section 952. Issuers that are controlled companies, limited partnerships, involved in bankruptcy proceedings, foreign private issuers that provide annual disclosure to shareholders of the reasons why the foreign private issuer does not have an independent compensation committee or open-ended management investment companies registered under the Investment Company Act of 1940 may all be exempted from these new listing standards.

The standards set forth in Section 951 require that all compensation committee members be members of the board of directors of the issuer and "independent." The SEC's rulemaking shall require listing standards that consider factors such as the source of compensation of a member of the board of directors of an issuer, including any consulting, advisory, or other compensatory fee paid by the issuer and whether a member of the board of directors of an issuer is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer. Section 951 provides the SEC with authority to allow the exchanges to adopt listing standards that exempt a particular relationship from these rules as the exchanges determine is appropriate taking into consideration the size of an issuer or other relevant factors.

What to do: These requirements are substantially similar to current rules for audit committee independence under Rule 10A-3 so companies should review the independence determinations made with respect to the current or proposed members of their compensation committees to determine if the members would meet the current audit committee independence standards of Rule 10A-3 and their exchange.

Section 952 further provides that compensation committees of public companies may, in their sole discretion, hire compensation consultants, legal counsel or other advisors and that public companies must provide for appropriate funding, as determined by the compensation committee, for reasonable compensation of compensation consultants, legal counsel or other advisors. For annual meetings of shareholders (or special meeting in lieu of the annual meeting) occurring on or after **July 21, 2011**, Dodd-Frank will require proxy disclosure whether the compensation committee retained or obtained advice of a compensation consultant. Further disclosure will be required if the work of the compensation consultant has raised any conflict of interest, including the nature of such conflict and how the conflict is being addressed.

Section 952 also requires compensation committees to consider standards to be adopted by SEC rulemaking when selecting compensation consultants, legal counsel or other advisors. The SEC's rulemaking should include factors that affect the independence of such advisors including other services provided by the advisor to the issuer, the amount of fees received by the advisor as a percentage of total revenue of the advisor, conflict of interest policies of the advisor any business or personal relationship between the advisor an a member of the compensation committee and any stock of the issuer owned by the advisor.

What to do: Companies should review the current advisors to the compensation committee to consider the potential disclosures that may be required by SEC rulemaking implementing this section as the disclosures will likely go beyond those already required by Regulation S-K Item 402(e). They should also review the charter of the compensation committee to ensure that it provides the authority to hire advisors.

Additional Proxy Disclosures

Sections 953, 955 and 972 of Dodd-Frank direct the SEC to issue rules relating to various disclosure items in public company proxies. The effective dates of these new rules will be contained in the final SEC adopting releases. These new SEC rules will include disclosures concerning:

- the relationship between pay and performance;
- pay comparisons between the total annual compensation paid to a company's chief executive officer and all the median annual compensation of other employees;
- hedging activities by insiders; and
- board structure and leadership.

What to do: Issuers should monitor closely the SEC rulemaking with respect to the pay comparison, as considerable time, expenditures and effort are currently required to determine the proper disclosure of the total compensation of the named executive officers, and the expansion of this effort to include comparable calculations for all non-CEO employees will require significant care and effort. Companies should pay close attention to the SEC rulemaking in this area to see how the calculation of total compensation by all employees is to be carried out.

The additional disclosures required by Section 972 with respect to board leadership structure do not appear to be materially different than those imposed by the SEC in the late 2009 adoption of Regulation S-K Item 407(h).

Item 402 of Regulation S-K already includes a discussion of hedging policies as one of the items that companies should discuss in their Compensation Discussion and Analysis; however, such policies or discussions may have been limited to named executive officers.

What to do: Dodd-Frank expands hedging disclosure to cover policies applicable to all employees and directors, so companies will need to update their proxy disclosure to describe the policy, if any, applicable to these additional groups. Many companies have adopted insider trading policies that prohibit hedging transactions by officers and directors in company shares – they may want to consider whether these prohibitions should be broadly applied to all of their employees.

Compensation "Clawback" Provisions

Section 954 of Dodd-Frank requires that the SEC adopt rules to require national securities exchanges and national securities associations to enact listing standards that will require issuers (1) to provide disclosure of compensation policies relating to incentive-based compensation and (2) to enact clawback policies that allow issuers to recover any incentive-based compensation from current or former executive officers for the prior three years in the event of a financial restatement due to material noncompliance with any financial reporting requirement under the securities laws. The effect of Section 954 will be that all companies listed on a national exchange will be required to have a clawback policy covering all current and former executive officers – the prior rules only required companies to seek recoupment from the CEO and the CFO. The amount of the recovery would be equal to the difference between the amount of incentive-based compensation received and the amount that should have been received under the restated financial results. Unlike current Sarbanes-Oxley clawback rules, Dodd-Frank does not require misconduct by the company or its executives to trigger the clawback and it expands the clawback to look back three years rather than one.

What to do: Those companies that have adopted clawback policies with conduct standards will need to amend the policies to broaden their scope and make other changes to ensure they comply with the SEC rules as adopted.

Broker Discretionary Voting

Brokers will face additional limits on their ability to vote shares in the absence of direction from beneficial owners under Section 957 of Dodd-Frank. In 2009 the NYSE already eliminated this "discretionary voting" for uncontested director elections and Dodd-Frank will expand these limits to prevent discretionary voting by brokers for shareholder votes with respect to executive compensation or "any other significant matter."

What to do: In 2010 most companies already evaluated the impacts of the NYSE rules on their proxy strategy – they should revisit this strategy again in light of the new say on pay votes described above and this expansion of the limits on brokers' discretionary voting.

SEC Authority to Enact Shareholder Access to Company Proxy

For many years the SEC has considered ways to expand shareholder access to the proxy materials sent by issuers to include shareholder-nominated director candidates. These considerations have led to several SEC rule proposals but have not yet resulted in definitive rules. Section 971 of Dodd-Frank grants the SEC explicit authorization to issue rules to permit shareholder use of an issuer's proxy solicitation materials for the purpose of nominating individuals to the board. Like, Section 951 of Dodd-Frank, this section also authorizes the SEC to exempt, by rule or order, an issuer or class of issuer from all of the proxy access rules and the section specifically orders the SEC to consider a disproportionate effect that the requirements may have on small issuers. On July 14, 2010, the SEC issued a concept release on the U.S. proxy system which can be found here.

Relief Relating to Auditor Attestation of Internal Controls

Section 989G of Dodd-Frank provides a permanent exemption of the auditor attestation of the effectiveness of internal controls requirements of Sarbanes-Oxley Section 404(b) for non-accelerated filers (including smaller reporting companies). Since the adoption of Sarbanes-Oxley Section 404(b) in 2003, the SEC has granted a number of temporary exemptions to smaller companies. Dodd-Frank provides the permanent relief for non-accelerated filers that many were hoping for.

Additional Disclosures and Prohibited Pay Arrangements for Covered Financial Institutions

Section 956 of Dodd-Frank provides enhanced disclosure obligations and prohibits certain pay practices for "covered financial institutions" – which includes depositary institutions, broker-dealers registered under the Securities Exchange Act, credit unions, investment advisors, Fannie Mae, Freddie Mac and any other institution included by the rules of Federal regulators -- so long as such institution has assets greater than $1 billion. The disclosures, which must be made to Federal regulators, include the structure of incentive-based compensation arrangements which provide executive officers with "excessive compensation" or could lead to material financial loss by the institution. The section further authorizes Federal regulators to enact rules (and mandates that such rules be prescribed within nine months of the enactment of Dodd-Frank) to prohibit any types of incentive-based compensation arrangements that regulators determine encourages inappropriate risks by covered financial institutions. The contours of these disclosures and compensation prohibitions will be determined through extensive rulemaking by a number of Federal regulators and covered financial institutions should pay attention to the progress of these regulations in the coming months and years.

Accredited Investor Standards

Section 413 of Dodd-Frank requires the SEC to modify its rules under the Securities Act of 1933 (Regulation D) regarding the definition of "accredited investor." The accredited investor definition is amended to exclude the value of a person's primary residence when applying the $1 million individual net worth test. This change became effective on July 21, 2010, with no transition period or grandfathering for private offerings that are in progress on that date but not yet completed. Section 413 of Dodd-Frank also requires the SEC to undertake a review of the other portions of the accredited investor definition in light of the economy and other factors and to implement new rules following such review if it determines that other changes are necessary in order to protect investors and the public interest.

What to do: Companies issuing securities to investors who are natural persons in private placements should immediately review the procedures in place for determining whether such investors are "accredited" under Regulation D.

Whistleblower Protections

Section 929A of Dodd-Frank expands the whistleblower protections of Sarbanes-Oxley to additional employees. Non-publicly traded subsidiaries of publicly traded companies are now covered by Sarbanes-Oxley, by amendment to the definition of "publicly traded company" to include any "subsidiary or affiliate whose financial information is included in the consolidated financial statements of such company." Prior to this amendment, the Department of Labor took the position that employees of non-publicly traded subsidiaries were generally not covered by the Act absent a showing of a substantial nexus between the parent and subsidiary, substantially narrowing the scope of coverage.

Other sections of Dodd-Frank make additional important changes to the landscape of employee whistleblower protections, including new strong monetary incentives provided to employees to report compliance issues to the SEC and CFTC.

What to do: Companies would be well served to review their internal whistleblower procedures and policies as soon as possible to ensure that they require internal reporting and the maximum opportunity to address compliance concerns before employees provide information to federal agencies in pursuit of generous bounties. In addition, subsidiaries and affiliates of publicly traded companies who will now be covered by Sarbanes-Oxley should review, and if necessary, enhance, as well as train line management in, their existing anti-retaliation procedures to protect against Sarbanes-Oxley whistleblower claims by their employees.