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EXECUTIVE COMPENSATION

Executive Compensation, Corporate Governance and Other Securities Disclosure Provisions in the Dodd-Frank U.S. Financial Regulatory Reform Act

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On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the ''Act''), the most comprehensive financial regulatory reform legislation in decades. Reaching far beyond the financial services industry, the Act contains executive compensation, corporate governance and other securities disclosure provisions that will affect all public companies.

The Act promises to alter the compensation and corporate governance landscape, providing a greater role for shareholders, increasing the influence of proxy advisory firms and activist investors and placing added pressure on companies and compensation committees. Public companies face a number of challenges, including re-examining their compensation practices and disclosures, considering a broader range of relationships with compensation committee members, reassessing arrangements with compensation committee consultants, advisors and counsel and preparing for upcoming non-binding shareholder advisory votes on executive compensation (or ''say-on-pay'').

Many of the Act's provisions require rulemaking by the Securities and Exchange Commission (''SEC''). Other provisions, while not mandating SEC rulemaking, nevertheless may result in SEC rules, in part due to numerous ambiguities in the Act's language. Thus, the exact requirements necessary for public companies to implement the Act's provisions in many cases will depend on the terms of any rules that the SEC adopts. On July 27, 2010, SEC Chairman Mary L. Schapiro announced that the SEC has established procedures for the public to submit comments in advance of the SEC's proposed rules to implement the Act. Public companies should consider taking advantage of this opportunity and engage with the SEC early to make known their views on the topics of SEC rulemaking.

1. Executive Compensation Provisions

Subtitle E of Title IX contains executive compensation provisions, most of which apply to all public companies. The Act both imposes substantive requirements related to executive compensation and enhances compensation disclosure obligations.

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A. Non-Binding Shareholder Vote on Executive Compensation (or "Say-on-Pay"). Section 951 of the Act adds a new Section 14A to the Securities Exchange Act of 1934 (the ''Exchange Act'') that requires every public company to hold an annual, biennial or triennial non-binding shareholder advisory vote (''say-on-pay'') to approve the compensation of named executive officers as disclosed pursuant to the executive compensation requirements of Item 402 of Regulation S-K. The Act makes clear that the say-on-pay votes are non-binding and will not overrule any decision of the company or its board of directors or otherwise affect the board's fiduciary duties. Companies also are required to provide for a shareholder vote no less frequently than every six years on a separate resolution to determine whether the say-on-pay vote will take place every one, two or three years.

Unlike the Emergency Economic Stabilization Act of 2008 (as amended, ''EESA''), which required all TARP recipients to hold say-on-pay votes, the Act does not mandate that the SEC adopt rules or regulations to implement this provision, although the SEC has general rulemaking authority under the Exchange Act.[1] In addition, the Act grants the SEC the authority to exempt companies from the provision taking into account, among other factors, whether the requirement disproportionately burdens small issuers.

Effective Date: The first shareholder say-on-pay vote and first shareholder vote on the frequency of say-on-pay votes must take place at the first annual or other shareholder meeting occurring on or after January 21, 2011 (six months after enactment).

Observations: Under current SEC rules, say-on-pay votes conducted by companies other than TARP recipients require the issuer to file a preliminary proxy statement, although we expect that the SEC will amend its rules to eliminate this requirement. The SEC also might provide guidance on how the say-on-pay vote resolution and the resolution on the frequency of say-on-pay votes can be phrased. Notably, under current SEC rules, it would be unlawful for a company to offer three alternatives with respect to the shareholder vote on the frequency of say-on-pay votes,[2] and such a vote raises a number of significant practical issues, including what standard is necessary for a particular alternative to be approved.[3]

[1] The SEC adopted Release No. 34-61335 on say-on-pay applicable to TARP recipients, effective February 18, 2010. Under this rulemaking, the SEC provided that the inclusion of a shareholder advisory vote would not trigger an obligation to file a preliminary proxy and also that it would not require TARP recipients to use any specific language or form of resolution in order to provide flexibility in how recipients presented the required vote.

[2] *See* Rule 14a-4(b) under the Exchange Act, which states that a form of proxy must allow a shareholder to specify by boxes ''a choice between approval or disapproval of, or abstention with respect to each separate matter'' other than director elections.

[3] Section 216 of the Delaware General Corporation Law provides, for example, that the default voting standard for matters other than director elections is a majority of shares present (either in person or represented by proxy) that are entitled to vote.

B. Non-Binding Shareholder Vote on and Disclosure of Golden Parachute Compensation. New Section 14A of the Exchange Act also provides that, in connection with a shareholder vote to approve an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all the assets of a company, each person soliciting votes on the transaction must: (1) disclose any agreements or understandings with named executive officers concerning any compensation that is based on or otherwise relates to the transaction and the total of all such compensation (''golden parachute compensation''); and (2) hold a separate non-binding shareholder advisory vote on such agreements, understandings and compensation, unless such agreements or understandings already have been subject to a say-on-pay vote by shareholders. The Act requires that the disclosure be prescribed by SEC regulations and cover all types of compensation (i.e., present, deferred or contingent), the aggregate total of the compensation and any conditions to which the compensation is subject. As with say-on-pay votes, the golden parachute advisory votes will not overrule any decision of the company or its board of directors or otherwise affect the board's fiduciary duties.

The provision applies to all public companies, although the SEC has the authority to exempt companies taking into account, among other factors, whether the provision disproportionately burdens small issuers.

Effective Date: New Section 14A's golden parachute provision applies to shareholder meetings occurring on or after January 21, 2011 (six months after enactment).

Observations: In light of the golden parachute compensation provision, companies and executives may be inclined to more definitively establish change-in-control compensation arrangements in advance, so that such arrangements can be subject to approval under a say-on-pay vote instead of being separately voted on in the context of a merger, although the parameters of what it means for an agreement or understanding to have been the subject of previous say-on-pay votes by shareholders are somewhat ambiguous. Note that, depending on a transaction's circumstances, two shareholder votes on golden parachute compensation may be required, one each for the acquiring company and target company.

C. Disclosure of Institutional Investment Manager Say-on-Pay and Golden Parachute Votes. New Section 14A also requires that institutional investment managers subject to Section 13(f) of the Exchange Act disclose no less than annually how they voted on any say-on-pay and golden parachute matters. Institutional investment managers who already are required by the SEC to report how they have voted are exempt from this requirement.

Effective Date: The requirement applies to say-on-pay and golden parachute votes that take place on or after January 21, 2011 (six months after enactment).

Observations: This provision will result in increased publicity surrounding, and likely activist investor pressure on, Schedule 13F institutional money managers with respect to their proxy voting. Schedule 13Fs are filed by entities or persons who manage more than $100 million in specified exchange traded securities. While the rules will apply to entities beyond those investment companies and investment managers reporting their

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voting results under existing SEC rules,[4] firms that deal primarily in options and derivatives, rather than underlying securities, may escape this provision since those securities do not count toward the Schedule 13F reporting threshold.

D. Compensation Committee Independence and the Role of Compensation Consultants and Other Advisers. Similar to the heightened independence requirements imposed on audit committees and their advisers under the Sarbanes-Oxley Act of 2002 (the ''Sarbanes-Oxley Act''), Section 952 of the Act mandates that stock exchanges adopt listing standards requiring listed companies to have independent compensation committee members. Section 952 also mandates that compensation committees assess the independence of compensation consultants and other advisers to the compensation committee (including legal counsel). The requirements of Section 952 are included in a new Section 10C of the Exchange Act. The provisions of Section 10C are to be implemented through exchange listing standards. Section 10C does not apply to controlled companies. The exchanges have authority to exempt companies from Section 10C's listing requirements as they determine appropriate, taking into account the potential impact on smaller companies.

The following is a brief description of each subsection of Section 10C:

Committee Member Independence. Section 10C(a) requires that each member of a board's compensation committee be independent under a definition of independence to be established by the exchanges. In adopting this definition, the exchanges must consider the sources of compensation paid to any compensation committee member (including any consulting, advisory or other compensatory fees paid) and whether the member is affiliated with the issuer. Companies will be provided with a reasonable opportunity to cure any defects prior to delisting. While the other provisions of Section 10C apply to all listed companies other than controlled companies, the exclusions in Section 10C(a) are broader, as the subsection applies to all listed companies other than controlled companies, limited partnerships, companies in bankruptcy, registered open-ended investment management companies and foreign private issuers that provide annual disclosures to shareholders of the reasons why they do not have an independent compensation committee.

Compensation Consultant and Other Adviser Independence. Section 10C(b) requires that any compensation consultant and other adviser to the compensation committee be selected only after the compensation committee has taken into account independence factors to be established by the SEC, which factors must be competitively neutral and preserve the ability of compensation committees to retain any category of adviser. These factors must include: (1) provision of other services by the employer of the compensation consultant or adviser; (2) the amount of fees received by the employer of the compensation consultant or adviser as a percentage of its total revenue; (3) policies of the employer of the compensation consultant or adviser that are designed to prevent conflicts of interest; (4) any business or personal relationship between the compensation consultant or adviser and a member of the compensation committee; and (5) any stock of the issuer owned by the compensation consultant or adviser.

Authority to Retain, and Disclosure Regarding Use of, Compensation Consultants. Section 10C(c) provides that a compensation committee in its sole discretion may retain or obtain the advice of a compensation consultant and shall be directly responsible for the appointment, compensation and oversight of a compensation consultant. However, the committee is not required to follow the recommendations of such consultant and must continue to exercise its own judgment in fulfilling its duties. In each proxy statement filed by an issuer for an annual meeting occurring on or after July 21, 2011 (the first anniversary of the Act's enactment), the company must disclose whether the compensation committee has retained or obtained the advice of a compensation consultant, whether the consultant's work raised any conflicts of interest and how any such conflicts are being addressed.

Authority to Retain Other Advisers. Section 10C(d) provides that a compensation committee also in its sole discretion may retain or obtain the advice of independent legal counsel and other advisers. Again, the committee must be directly responsible for the appointment, compensation and oversight of these advisers, but is not required to follow the recommendation of such counsel or advisers to the compensation committee.

Funding. Under Section 10C(e), issuers are required to provide appropriate funding for compensation consultants, independent legal counsel and other advisers to the compensation committee.

Effective Date: Section 10C requires the SEC to adopt rules no later than July 16, 2011 (360 days after enactment), directing the exchanges to prohibit the listing of any company not in compliance with the new section's requirements.

Observations: The compensation committee member independence provision largely parallels Exchange Act Section 10A applicable to audit committee members, and thus Rule 10A-3 under the Exchange Act provides a guide to what the listing standards for compensation committee member independence might entail, although the Act's provision is not as prescriptive. In contrast to Section 10A, Section 10C does not require compensation committees to retain any consultant or adviser used by the company. Further, the compensation committee is not required to use only independent advisers (although the statute refers to ''independent legal counsel,'' it also allows the committee to retain ''other advisers''). The disclosure requirements regarding the compensation committee's use of, and independence analysis regarding, compensation consultants are broader than recently adopted SEC rules regarding fees paid to compensation consultants, and thus will require disclosures of other factors (including, for example, family relationships with the consultant or the consultant's reliance on an engagement for a significant portion of his or her business) that could affect compensation consultant independence.[5]

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[4] Since 2004, investment companies (including mutual funds) have been required to file an annual statement on Form N-PX disclosing their votes during the 12 months ending on June 30 of the most recent year. *See* the SEC's Release No. 33-8188.

[5] *See* Rule 407(e) of Regulation S-K, amended pursuant to the SEC's Release No. 33-9089, effective February 28, 2010.

E. Executive Compensation Disclosures. ***Pay Versus Performance***. Section 953 of the Act adds a new Section 14(i) to the Exchange Act that directs the SEC to adopt rules requiring each public company to disclose in its annual meeting proxy statement the relationship between executive compensation ''actually paid'' and the company's financial performance. The presentation is required to ''take into account'' changes in the value of the shares of stock and dividends of the company and any distributions. The disclosure may, but is not required to, include a graphic representation of this required information.

Effective Date: The Act does not prescribe a time period in which the SEC must adopt rules implementing the ''pay versus performance'' disclosure requirement.

Observations: A stock price performance graph is required to be included in a company's annual report to shareholders pursuant to existing SEC rules,[6] but the Act's provision is more prescriptive than the current rules and requires that companies present an explicit comparison between pay and financial performance, although it is not required to be in graphic form. This provision, along with the required say-on-pay vote, may cause companies to rethink some of the disclosure in their Compensation Discussion and Analysis (''CD&A'') and focus more on graphical presentations of the links between pay and performance in various elements of compensation.

Internal Pay Ratio. Section 953 of the Act also directs the SEC to amend Item 402 of Regulation S-K to require each public company to disclose in its SEC filings described in Item 10(a) of Regulation S-K (such as its annual proxy statement): (1) the median of annual total compensation of all employees, other than the CEO (or any equivalent position); (2) the annual total compensation of the CEO (or any equivalent position); and (3) the ratio of those two amounts. For the purposes of complying with this requirement, ''total compensation'' must be determined in accordance with Item 402(c) of Regulation S-K, as in effect the day before the Act's enactment.

Effective Date: The Act does not prescribe a time period in which the SEC must adopt rules implementing the internal pay ratio disclosure requirement.[7]

Observations: This provision likely will be the most difficult, expensive and time-consuming of the Act's executive compensation provisions applicable to public companies and could impose an enormous burden on companies of all sizes. Given the complexity of calculating total compensation under Item 402(c) for named executive officers,[8] the difficulty of calculating total compensation for all employees should not be underestimated. In addition to issues such as what point in time the calculation must be done and which employees must be included (full time employees only, employees on medical or military leave, etc.), the provision will raise a host of interpretive questions that do not normally arise with respect to executive officers, such as whether statutorily prescribed benefits provided to employees in some countries are treated as perquisites.

Hedging Policy. Section 955 of the Act adds a new Section 14(j) to the Exchange Act that directs the SEC to adopt rules requiring each public company to disclose in its annual proxy statement whether its employees or directors (or any of their designees) may purchase financial instruments that are designed to hedge or offset decreases in the value of securities granted to employees or directors as a part of employee compensation or other securities held directly or indirectly by the employees or directors.

Effective Date: The Act does not prescribe a time period in which the SEC must adopt rules implementing the hedging policy disclosure requirement.

Observations: While this provision requires disclosure of policies applicable to all employees, it does not prevent an issuer from having (and disclosing) one policy that is applicable to its directors and executives and another policy applicable to rank-and-file employees. In this regard, many companies already have such policies in place for their executive officers and disclose them in their CD&A.

F. Recovery of Erroneously Awarded Compensation (Clawbacks). Section 954 of the Act adds a new Section 10D to the Exchange Act that requires the SEC to direct the exchanges to prohibit the listing of any company that does not adopt ''clawback'' policies to recover compensation in certain circumstances. Specifically, each listed company must adopt and implement a policy: (1) for disclosure of the company's policy for incentive-based compensation that is based on the financial information required to be reported under the securities laws; and (2) to recoup from any current or former executive officers incentive compensation paid during a three-year look-back period based on erroneous data if the company is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws, regardless of whether the individual was involved in misconduct that led to the restatement. The amount to be recovered is the excess of what would have been paid under the restated financial statements.

Effective Date: The Act does not specify a time period in which the SEC is required to direct the exchanges to adopt these rules relating to clawback policies.

Observations: The Act's clawback provision represents a middle ground between the provision applicable to TARP recipients under EESA and the current provision applicable to all public companies under the Sarbanes-Oxley Act, but is more stringent than the clawback provisions voluntarily adopted by many companies. Under the Sarbanes-Oxley Act, the clawback is limited in scope (i.e., applicable only to the Chief Executive Officer and Chief Financial Officer), duration (i.e., a 12 month look-back period) and grounds (i.e., misconduct is required). The clawback provision under EESA is not triggered by an accounting restatement, but only requires a material inaccuracy in the company's financial statements and/or performance metrics and does not contain a misconduct requirement.

There also are some ambiguities in the provision that will need to be addressed by SEC rulemaking. For ex-

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[6] *See* Item 201(e) of Regulation S-K.

[7] In July 20, 2010 testimony before the U.S. House of Representatives Committee on Financial Services, Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises, SEC Chairman Mary L. Schapiro suggested that rules implementing the internal pay ratio disclosure requirement may not be in place in time for the 2011 proxy season.

[8] Under Item 402(c) of Regulation S-K, total compensation includes the dollar value of annual salary, bonus, stock awards, option awards, non-equity incentive plan compensation, non-qualified deferred compensation earnings and all other compensation.

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ample, while the provision refers to equity compensation, it is not clear that clawback policies are required to apply to all forms of equity awards, or only equity awards that are granted or vest on the basis of financial performance. In particular, institutional investors typically do not view time-vested options and stock awards as ''incentive compensation'' and the value of such awards is not directly tied to information reported in a company's financial statements.

Note also that because the clawback policies mandated by the Act will be adopted pursuant to listing standards, it does not appear that they will be enforceable in private actions.

G. Enhanced Compensation Disclosures and Certain Compensation Prohibitions for Regulated Financial Institutions. Section 956 of the Act imposes new requirements on incentive compensation paid by covered financial institutions with more than $1 billion in assets. For the purposes of this provision, a ''covered financial institution'' means a depository institution, registered broker-dealer, credit union, investment adviser, Fannie Mae, Freddie Mac and any other financial institution that federal regulators determine should be covered. Section 956 requires covered financial institutions to disclose to their respective federal regulators the structure of all incentive-based compensation arrangements sufficient to determine whether: (1) excessive compensation, fees or benefits are provided to executive officers, other employees, directors or principal shareholders; and (2) the incentive-based compensation arrangements could lead to material financial losses to the institution. In addition, the Act requires applicable financial regulators to prohibit incentive-based payment arrangements that in their determination encourage ''inappropriate risks'' by covered financial institutions, either by providing excessive compensation or by creating the possibility of material financial losses to the institution.

Although the Act does not define ''excessive compensation,'' it does direct federal regulators to consider the compensation standards included in Section 39(c) of the Federal Deposit Insurance Act, which take into account the combined value of all benefits provided to the individual, the financial condition of the institution and the levels of compensation at comparable institutions, among other factors.

Effective Date: The applicable federal regulators, including the Federal Reserve, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Office of Thrift Supervision, National Credit Union Administration Board, Federal Housing Finance Agency and the SEC, are required to prescribe jointly regulations or guidelines for this provision no later than April 21, 2011 (nine months after enactment).

H. Voting by Brokers. Section 957 of the Act amends Section 6(b) of the Exchange Act to require exchanges to prohibit a broker that is not the beneficial owner of a company's shares (e.g., shares held in street name on behalf of retail investors) from granting a proxy to vote the shares in connection with a shareholder vote in director elections, with respect to executive compensation or on ''any other significant matter'' (as determined by the SEC by rule) unless the beneficial owner has provided the broker with voting instructions.

Effective Date: The Act does not prescribe a time by which exchanges are required to implement policies relating to the broker voting prohibition, but could be read as requiring immediate action.

Observations: In effect, this provision codifies and expands the effect of the SEC's July 2009 approval of amendments to NYSE Rule 452 to eliminate uninstructed broker voting in uncontested director elections so that it also applies to say-on-pay votes and other significant matters.[9] The provision is likely to be most significant with respect to say-on-pay votes mandated by the Act.

2. Corporate Governance Provisions

Title IX, Subtitle G of the Act contains corporate governance provisions relating to proxy access and disclosures of board leadership structures. In addition, Title I, Subtitle C requires the establishment of risk committees at certain publicly traded financial institutions. Note that the majority voting provision contained in the earlier Senate bill was dropped during the conference committee process.

A. Proxy Access. Section 971 of the Act amends Section 14(a) of the Exchange Act to authorize, but not require, the SEC to issue rules permitting shareholders to have one or more director nominees included in company proxy solicitation materials.

Effective Date: The Act does not mandate implementation of proxy access nor provide a timeline for the adoption of SEC's rules relating to proxy access.

Observations: The Act's proposal follows extensive debate on the issue of proxy access at both the state and federal levels. In June 2009, the SEC issued proposed proxy access rules. Subsequently, Delaware amended its corporation law to allow companies to adopt bylaw provisions requiring the inclusion of shareholder nominees in the company's proxy solicitation materials. Also in 2009, the ABA's Committee on Corporate Laws amended the Model Business Corporation Act to include a proxy access provision similar to that enacted in Delaware.

On August 25, 2010, the SEC adopted final proxy access rules that: (1) establish a federal proxy access right pursuant to new Rule 14a-11 and related amendments; and (2) amend Rule 14a-8 to permit shareholder proposals that would establish certain additional proxy access procedures.[10] Rule 14a-11 will allow a shareholder or group of shareholders to have director nominees included in a company's proxy materials if the shareholder or group beneficially own at least 3 percent of the total voting power of the company's securities for at least three years. As a result of the amendment to Rule 14a-8, companies will not be able to exclude a proxy access shareholder proposal under Rule 14a-8(i)(8) that seeks less restrictive conditions than those of Rule 14a-11.

B. Disclosures Regarding Board Leadership Structures. Section 972 of the Act adds a new Section 14B to the Exchange Act that directs the SEC to issue rules requiring companies to include in their annual proxy state-

[9] *See* the SEC's order approving the rule change.

[10] *See* the SEC's Release No. 33-62690, issued August 25, 2010. For more information regarding the SEC's proxy access rules, see our client alert at http://www.gibsondunn.com/publications/Pages/SECFinalProxyAccessRules.aspx.

ments the reasons why they have chosen the same person, or different people, to serve as chairman and chief executive officer.

Effective Date: The Act requires the SEC to issue rules on disclosures of board leadership structures by January 17, 2011 (180 days after enactment).

Observations: The Act's disclosure-based approach is similar to the proxy disclosure rules adopted by the SEC in December 2009.[11] These rules require enhanced disclosure about a company's board leadership structure, including a discussion of: (1) whether the company has combined or separated the CEO and chairman positions; (2) if combined, whether the company has a lead independent director and the specific role of such director in the company's leadership; and (3) why the company believes its structure is the most appropriate for the company.[12] Given the similarities between what the Act requires and the rules adopted in December 2009 by the SEC, it appears that the Act does not require the SEC to significantly alter its current rules.

C. Risk Committees. Section 165 of the Act directs the Federal Reserve to require publicly traded nonbank financial institutions supervised by the Federal Reserve and publicly traded bank holding companies with at least $10 billion in assets to establish a separate risk committee of the board of directors. The Act also authorizes the Federal Reserve to issue regulations requiring publicly traded bank holding companies with less than $10 billion in assets to form risk committees. The risk committee is required to: (1) oversee the financial institution's risk management practices; (2) include a number of independent directors determined by the Federal Reserve, based on the nature of operations, size of assets and other criteria; and (3) include at least one risk management expert with experience in identifying, assessing and managing risk at large, complex financial institutions.

Effective Date: The Act requires the Federal Reserve to adopt the risk committee rules no later than July 21, 2012 (two years after enactment), to take effect no later than October 21, 2012 (two years and three months after enactment).

Observations: This provision differs from one proposed in an earlier Senate bill, which would have required that the boards of all listed public companies, with limited exceptions, form a separate risk committee composed solely of independent directors. The Act's risk committee provision will not affect the vast majority of public companies, many of which currently address risk through the full board or another board committee.

Although the SEC adopted rules in December 2009 requiring companies to disclose the extent of the board's role in the company's risk oversight,[13] most companies did not form risk oversight committees but instead delegate responsibility for risk oversight among the board committees and the full board.

[11] *See* the SEC's Release No. 33-9089, issued on December 16, 2009 (adopting Item 407(h) of Regulation S-K).

[12] *See* Item 407(h) of Regulation S-K. See also our client alert issued on December 16, 2009 for more information regarding the SEC's amended proxy disclosure rules.

[13] *See* the SEC's Release No. 33-9089, issued December 16, 2009.

3. Other Federal Securities Disclosure Provisions

The Act contains a number of additional federal securities disclosure provisions relevant to public companies, on matters ranging from the timing of Form 3 filings to disclosures regarding mine safety.

A. Beneficial Ownership and Short-Swing Profit Reporting. Section 929R amends Section 13(d) of the Exchange Act to authorize, but not require, the SEC to issue rules shortening the period of time within which a Schedule 13D must be filed in connection with acquiring beneficial ownership of more than 5 percent of a registered class of equity securities. Currently, a Schedule 13D must be filed within ten days of a shareholder acquiring beneficial ownership of such amount.

Section 929R similarly amends Section 16(a) of the Exchange Act to authorize, but not require, the SEC to issue rules shortening the period of time within which a Form 3 must be filed in connection with becoming a director, officer or greater than 10 percent shareholder of a public company. The current rule requires a Form 3 to be filed within ten days of such occurrence.

Effective Date: The Act does not provide a timeline for the adoption of the SEC's rules, if any, under Section 929R.

B. Disclosures of Ratings and Disclosures to Rating Agencies. The Act contains a number of provisions addressing the regulation of credit rating agencies, two of which are particularly relevant to public companies.

Elimination of Regulation FD Exemption. Section 939B of the Act requires the SEC to amend Regulation FD to remove the express exemption for communications with rating agencies that is set forth in Section 100(b)(2)(iii).

Effective Date: The Act requires the SEC to revise Regulation FD on or before October 19, 2010 (90 days after enactment).

Observations: If the SEC amends Regulation FD in the exact manner specified in the Act, we do not expect this provision to have significant consequences. Regulation FD was designed to prevent selective disclosure of material nonpublic information to market participants. Rule 100(b)(1) sets forth a list of persons (broker-dealers, investment advisers, institutional money managers, investment companies and shareholders if it is reasonably foreseeable that they will trade on the basis of the information) with whom communications by an issuer or issuer representative trigger a duty of public disclosure under Regulation FD. At the time that Regulation FD was adopted, most rating agencies were registered with the SEC as investment advisers. Accordingly, to permit communications with rating agencies without triggering Regulation FD, Rule 100(b)(2)(iii) contains an exemption under which communications to rating agencies generally would not trigger Regulation FD. Since Regulation FD was adopted, however, rating agencies are now regulated under Exchange Act Section 15E, and the rating agencies that have qualified as nationally recognized statistical rating organizations (''NRSROs'') generally have terminated their registration as investment advisers. Accordingly, even without the exclusion set forth in Rule 100(b)(2)(iii), rating agencies are not covered persons that trigger Regulation FD. Instead, communicating with a rating agency

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can be viewed as equivalent to communicating with a news reporter or with a company's commercial bank. Even if the SEC were to amend Regulation FD to include rating agencies as covered persons that trigger Regulation FD, it would not be necessary to publicly disclose information provided to a rating agency if the rating agency agreed to maintain the information in confidence, consistent with Rule 100(b)(2)(ii) of Regulation FD.

Rescission of Securities Act Rule 436(g). Section 939G of the Act provides that Securities Act of 1933 (the ''Securities Act'') Rule 436(g) ''shall have no force or effect.'' Securities Act Rule 436(g) provided that credit ratings issued by NRSROs on debt securities, a class of convertible debt securities or a class of preferred stock were not considered part of a registration statement prepared or certified by a person within the meaning of Sections 7 and 11 of the Securities Act. Under the Securities Act, if a statement made by an expert is included or referred to in a Securities Act registration statement, the expert is subject to potential liability under Section 11 of the Securities Act (subject to a due diligence defense) and the issuer is required to file the expert's consent to being named in the registration statement. In connection with passage of the Act, the three major rating agencies operating in the U.S. have stated that they are not in a position to consent to being named as experts in Securities Act registration statements.

Effective Date: The repeal of Rule 436(g) takes effect July 22, 2010 (one day after enactment).

Observations: The repeal of Rule 436(g) has a number of significant implications for public companies and the public offering process.

■ **Incorporation by Reference of Exchange Act Disclosure**. Many issuers include statements in their Forms 10-K, 10-Q and 8-K regarding their credit ratings or changes to their credit ratings. These statements are automatically incorporated by reference into such issuers' registration statements on Forms S-3, S-4 or S-8. For example, a company's Form 10-K Management's Discussion and Analysis might have a discussion of the liquidity effect of a past credit ratings downgrade or discuss loan covenants that are dependent on credit ratings. Consistent with an October 2009 SEC rule proposal relating to the use of credit ratings, the SEC Staff issued Compliance and Disclosure Interpretations on August 11, 2010 stating that the SEC Staff will not consider certain types of disclosures of credit ratings in registered offerings to be a use in connection with an offering of securities, and thus such disclosures do not trigger the consent requirements of the Securities Act. Accordingly, discussion of credit ratings for the purpose of disclosing changes to a credit rating, the liquidity of the registrant, the cost of funds for a registrant or the terms of agreements that refer to credit ratings, may be acceptable. Moreover, Section 19(a) of the Securities Act provides that no liability may attach under the Securities Act for actions taken in good faith in conformity with an SEC rule notwithstanding that the rule is subsequently rescinded. Thus, with respect to credit ratings that were incorporated by reference into or that were included in a Securities Act registration statement that became effective before July 22, 2010, there would appear to be little purpose to requiring a rating agency's consent for such credit ratings disclosure since Section 19(a) would prevent expertized liability from arising with respect to credit ratings in this circumstance. However, with respect to registration statements that become effective, or are amended, on or after July 22, 2010, companies will have to take care not to include or refer to credit ratings in a way that would trigger the consent requirements, including through incorporation by reference from an Exchange Act filing, unless they have obtained the rating agency's consent. Companies also must use caution with respect to references to credit ratings in Form 10-Ks filed on or after July 22, 2010, unless such references are made in a context consistent with the interpretive position discussed above, since the filing of a Form 10-K is deemed to effect a post-effective amendment to a registration statement.

■ **Prospectus Supplements, Free Writing Prospectuses and Other Offering Material**. Disclosures of credit ratings in free-writing prospectuses under Rule 433 of the Securities Act, including pricing term sheets, and in press releases that comply with Securities Act Rule 134 do not trigger the consent requirements because these communications are not subject to Section 11. Similarly, offerings that are exempt from Securities Act registration, such as Regulation S offerings, should not be affected by the rescission of Rule 436(g). In contrast, offerings of asset backed securities that are registered under the Securities Act, which have traditionally been marketed conditioned upon assignment of a specified credit rating and that, as a result, are subject to a special Securities Act rule that requires inclusion of credit ratings in the registration statement, raise an issue, although the SEC Staff issued an interpretive letter to Ford Motor Co. that suspends for six months the operation of Regulation AB in this regard.[14]

C. Additional Disclosure Provisions. ***Conflict Minerals***. Section 1502 of the Act adds a new Section 13(p) to the Exchange Act that requires new disclosures relating to certain common minerals that are mined in the Democratic Republic of the Congo (''DRC''). ''Conflict minerals'' are defined as gold, columbite-tantalite (coltan) (also known as iron manganese, used in the manufacture of condensers, micro-electronic technology (chips and processors), cell phones, nuclear reactors and highly heat tolerant steel varieties), cassiterite (the major ore used in making tin), wolframite (the principal ore in tungsten which is used in many electrical items) or their derivatives. The disclosure requirement applies to *any person* who manufactures a product for which conflict minerals are necessary, either to produce the product or for the product to be functional. The SEC must adopt rules requiring such persons to disclose annually to the SEC whether any conflict minerals used by the person originated in the DRC or an adjoining country. If any conflict minerals used did originate in these areas, then the person must submit a report to the SEC detailing: (1) the measures taken to exercise due diligence on the source and chain of custody of the minerals (which measures must include an independent audit); (2) the products that will or have been manufactured containing minerals that directly or indirectly finance or benefit armed groups in the DRC or an adjoining country; and (3) additional information, including the facilities used to process the conflict minerals and the efforts used by the person to determine the conflict minerals' specific location of origin. The foregoing

[14] Ford Motor Credit Company LLC, SEC No-Action Letter (avail. July 22, 2010).

information also must be made publicly available on the person's website. The Act provides that this disclosure requirement will remain effective until the later of five years or the date on which the President determines that no armed groups directly or indirectly benefit from or are involved in commercial activity involving conflict minerals.

Effective Date: The SEC must adopt rules implementing the conflict mineral disclosure requirement no later than April 17, 2011 (270 days after enactment).

Coal or Other Mine Safety. Section 1503 of the Act requires each public company that operates, or has a subsidiary that operates, a coal or other mine to disclose mine safety information in each periodic report filed with the SEC on or after the date of enactment. This disclosure must include: (1) the total number of citations and orders received by the operator issued under certain provisions of the Federal Mine Safety and Health Act of 1977 (''FMSHA''); (2) a list of mines for which the operator has received notice from the Mine Safety and Health Administration of a pattern or potential pattern of health or safety standard violations; and (3) any pending legal action before the Federal Mine Safety and Health Review Commission involving a mine. In addition, beginning on the date of enactment, such companies must disclose on a Form 8-K the receipt of: (1) an imminent danger order issued under the FMSHA; and (2) written notice from the Mine Safety and Health Administration of a pattern or potential pattern of health or safety standard violations.

Effective Date: Effective now.

Payments by Resource Extraction Issuers. Section 1504 adds a new Section 13(q) to the Exchange Act to require disclosure of certain payments made by resource extraction issuers. Any issuer who files an annual report with the SEC and engages in commercial development of oil, natural gas or minerals must disclose in their annual report information relating to any payment made by the issuer to a foreign government or the U.S. federal government for the purpose of commercial resource development. The required information includes the type and amount of such payments made (1) for each resource development project and (2) to each government.

Effective Date: The SEC is required to adopt rules implementing this provision no later than April 17, 2011 (270 days after enactment), which rules will apply to annual reports for fiscal years ending after the first anniversary of the rules' adoption.

4. What Companies Should Do Now

The following sets out steps that companies should consider taking now to be prepared for the many changes contained in the Act.

■ **Say-on-Pay and Golden Parachutes**.

→ Revisit how compensation programs are presented in the company's Compensation Discussion and Analysis. Keep in mind that although the say-on-pay vote is not binding, negative votes could put pressure on compensation practices and directors, and the loss of broker votes on say-on-pay proposals will amplify the issue. In particular, consider ISS's guidelines as to pay practices that will cause it to issue a negative vote recommendation. The Council of Institutional Investors has also developed a list of ''red flags'' for shareholders to consider when analyzing compensation programs.

→ Monitor SEC rulemaking that will determine whether any specific language or form of resolutions is required to be used when drafting a say-on-pay or golden parachute proposal and whether the inclusion of a say-on-pay vote will trigger a preliminary proxy filing.

→ Begin to enhance communication with the proxy voting department at institutional investors, if not already established, to encourage affirmative voting on say-on-pay and any other anticipated significant matters.

■ **Enhanced Compensation Committee Independence**.

→ Analyze compensation committee members' director and officer questionnaires in order to determine if any independence issues may arise. For example, the prohibition on affiliates serving on the committee will be an issue if a significant investor or a provider of professional services serves on the compensation committee.

→ Clearly document whether outside compensation consultants, legal counsel or other advisers are retained by the compensation committee or by management.

→ Analyze engagements with outside compensation consultants, legal counsel and other advisers in order to be in a position to identify issues raised by the SEC rules on heightened independence requirements. This should be done on a worldwide basis for the company and its subsidiaries and also take into account affiliates of the consultants and advisers. One particular item to monitor is how the SEC rules will impact the independence of outside legal counsel who typically provides services to both the compensation committee and the company.

■ **Clawbacks**.

→ Evaluate all compensation arrangements that might be subject to the new clawback requirements, but keep in mind that the parameters of the required clawback policy will be defined by the SEC rules and listing standards that are adopted.

■ **Pay for Performance**.

→ Analyze how compensation will compare with financial performance, as determined under various measures such as stock performance and net earnings. ISS currently includes in its voting recommendation reports a chart comparing CEO compensation and stock performance, and ISS has advised that it may issue a negative vote recommendation if changes to the CEO's total pay is not aligned with Total Shareholder Return over certain time horizons.

→ Consider developing alternative presentations that the company believes may more effectively present the relationship between pay and performance based on its specific compensation programs.

■ **Internal Pay Ratio**. Assess mechanisms to determine whether it is possible to compute total compensation for all employees in accordance with Item 402(c) of Regulation S-K in order to determine the median amount of compensation to be compared to that of the CEO's. Companies should also begin to assess the factors that may contribute to a large disparity in the ratio, including number of employees and complexity of work performed by employees, in order to explain the disparity. ISS currently includes information in its reports on the pay disparity between the CEO and the next most highly compensated employee.

■ **Hedging disclosure**. Consider whether to adopt an anti-hedging policy applicable to executives and di-

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rectors and whether to make any such policy applicable to employees generally. If the company already has a policy in place, review the current policy to determine if any changes are advisable in anticipation of the public disclosure of the policy. While there is currently no SEC disclosure requirement for hedging policies, many companies already discuss them in their proxy statements and other address them in their insider/securities trading policies.

- **Risk Oversight**. Although the Act's risk committee provision applies only to certain publicly traded financial institutions, all companies should consider carefully their risk oversight process and structure, including whether the oversight function should rest with the whole board, the audit committee and/or other committees.
- **Credit Ratings**. Review references to credit ratings in Securities Act registration statements and Exchange Act filings and assess whether such references should be deleted in future filings and if other actions should be taken to address the possibility of their being incorporated by reference into Securities Act registration statements.

Final Recommendation: Be involved. Public companies should communicate early with the SEC on the topics of SEC rulemaking under the Act. On July 27, 2010, SEC Chairman Schapiro announced that the SEC is implementing a new process for the public to submit comments in advance of the SEC proposing rules and rule amendments to implement the Act. To facilitate public comment, the SEC has established a page on its website at http://www.sec.gov/spotlight/regreformcomments.shtml. Public companies should take advantage of this and other opportunities to actively engage with the SEC, as company input into the practical challenges and issues presented by the new legislation will be important.