Corporate and Securities Alert:

The Dodd-Frank Act: Provisions Affecting Corporate Governance And Executive Compensation Disclosures For All Public Companies

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On July 21, 2010, President Barack Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. This legislation is primarily focused on bank reform — regulation and resolution of financial companies that pose systemic risk, banking regulatory reform, regulation of derivatives, and consumer financial protection. However, the Act also makes significant changes to corporate governance and executive compensation rules for public companies in all industries. In this client alert we summarize these new requirements, their effective dates, and early impacts on companies in the technology, life sciences and clean tech industries.

Dodd-Frank Act Provisions

Executive Compensation Say-on-Pay

At least once every three years, public company shareholders must have a separate nonbinding vote on the Company's executive compensation, as disclosed in the proxy statement.

At least once every six years, the shareholders must vote to determine whether the say-on-pay vote should occur every one, two or three years.

Institutional investment managers must report, at least annually, their actions on say-on-pay votes.

The SEC is empowered to exempt small issuers from this provision of the Act.

Effective Date: Effective for annual shareholder meetings starting January 2011.

Impact:

- Management should assess the likely results of a Company say-on-pay vote next year, and advise the Board of Directors.
- Consider what frequency of shareholder say-on-pay vote to recommend to shareholders in 2011.
- Even if no changes to executive compensation arrangements are contemplated, a review of the company's current executive compensation disclosures, with say-on-pay in mind, is advisable.
- If executive compensation changes are contemplated, early attention to positioning for shareholder approval is advisable.
- Consider ways to make executive compensation disclosure more clear and concise, as it now has a persuasion function as well as a compliance function.
- The SEC may need to propose rules on whether preliminary proxy statement filings for say-on-pay votes are required, and any required content of the resolution for shareholder approval.

Dodd-Frank Act Provisions

Golden Parachute Say-on-Pay

Shareholders must have a separate say-on-pay vote on the compensation paid to executives in connection with a change in control transaction (i.e., "golden parachute" compensation) if that compensation has not previously been subject to a shareholder say-on-pay vote. Even if no vote is required, acquisition proxy statements must include disclosure of golden parachute compensation arrangements.

Institutional investment managers must report, at least annually, their actions on golden parachute say-on-pay votes.

The SEC is empowered to exempt small issuers from this provision of the Act.

Effective Date: Effective for shareholder meetings starting January 2011.

Impact:

- The SEC is likely to propose rules about what disclosure of golden parachute compensation is required.
- Generally expect to need a shareholder vote only for new agreements or modifications entered into in connection with the acquisition transaction.
- Executive compensation arrangements generally remain contractual commitments of the Company even if shareholders vote to disapprove them.

Broker Voting

National securities exchanges must adopt rules prohibiting brokers from voting shares of which they are not the beneficial owner with respect to election of directors, executive compensation (including say-on-pay votes) or any other "significant matter" unless specifically instructed by the beneficial owner with respect to such vote.

Effective Date: As soon as national securities exchanges (e.g., NYSE) revise their rules as directed (probably 2011).

Impact:

- Continued attention to the optics of shareholder voting totals.
- Additional emphasis on shareholder outreach.
- SEC rule-making required to identify other "significant matters" where uninstructed broker voting is prohibited.

Dodd-Frank Act Provisions

Compensation Committee Independence

The SEC and stock exchanges must require listed companies to have a Compensation Committee composed solely of independent directors. The SEC will promulgate rules about how to determine independence, including consideration of the following factors:

- The source of compensation of the directors, including any consulting, advisory or other fees paid by the Company to such director; and
- Whether the director is affiliated with the Company, a subsidiary of the Company, or an affiliate of a subsidiary.

The SEC is empowered to exempt small issuers from this provision of the Act.

Effective Date: SEC to issue rules within 360 days of enactment (July 2011).

Impact:

- Assess independence of Compensation Committee members assuming that standards similar to the current SEC Rule 10A-3 (audit committee independence) will apply.
- Nominating and Governance Committee to consider potential changes to Compensation Committee members in light of new requirements.
- Review committee charter and corporate governance principles.

Compensation Committee Advisers

The Company must provide funding and authority for the Compensation Committee to obtain the advice of independent compensation consultants, independent counsel and other advisers, at the discretion of the committee. In selecting advisers, the Compensation Committee must consider factors affecting adviser independence. The SEC will promulgate rules about these independence factors, which are to be competitively neutral.

Independence factors will include:

- Other services provided to the Company by the adviser's employer;
- Amount of fees that the adviser's employer received from the Company for such services, as a percentage of the total revenue of the adviser's employer;
- Conflict of interest policies of the adviser's employer;
- Business or personal relationships between the adviser and committee members; and
- Company stock owned by the adviser.

The Company's proxy statement must disclose whether the Compensation Committee engaged a compensation consultant, any conflicts of interest that arose, and how any such conflicts were addressed.

Effective Date: The Act requires the SEC to issue rules within 360 days of enactment.

Impact:

- Make a preliminary assessment of application of adviser independence criteria to the Company's existing advisers.
- Not required to retain an independent adviser, provided the Company considers the issue and addresses any potential conflicts.

Dodd-Frank Act Provisions

Additional Proxy Disclosures

Company must disclose, in its annual proxy statement, the relationship between compensation actually paid to executives and the financial performance of the Company.

Executive compensation disclosure generally must include the ratio of the CEO's total compensation to the median total compensation of all other employees.

Effective Date: The SEC is required to issue rules, but no deadline is specified.

Impact:

- Review current stock price performance chart; make preliminary assessment of executive compensation relative to stock price over different time frames (SEC to specify time to be presented).
- Calculation of the ratio of CEO pay to median employee pay is likely to be extremely complex.
- Expect SEC rule-making to deal with complexities.

Recovery of Erroneously Awarded Compensation (Clawback)

Company must disclose incentive-based compensation policies that are based on reported financial information. SEC and exchanges must require listed companies to have a policy that requires repayment ("clawback") of incentive compensation (including stock options) that was paid to current or former Company executives over the three-year period prior to any restatement due to material noncompliance with financial reporting requirements.

Effective Date: SEC to issue rules, but no deadline is specified.

Impact:

- Compensation Committee may wish to determine what elements of executive compensation are subject to potential clawbacks, and affected officers.
- Expect SEC rule-making to define incentive-based compensation, and calculation of recoverable excess compensation.

Employee and Director Hedging

Public companies must disclose whether any employee or director is permitted to purchase financial instruments that are designed to hedge or offset a decrease in market value of the Company's securities.

Effective Date: SEC to issue rules but no deadline is specified.

Impact:

- Implementation may be accomplished through insider trading policy or separately.

Additional Reporting Obligations for Financial Institutions

Certain financial institutions must disclose to appropriate federal regulators the details of incentive-based compensation arrangements, and limit incentives that could encourage inappropriate risks.

Dodd-Frank Act Provisions
Leadership Structure Company must disclose, in its annual proxy statement, why the same individual serves as chairman of the board and chief executive officer, or why different individuals serve in those capacities. *Effective Date:* SEC to issue rules by within 180 days of enactment (January 2011). *Impact:* • Some minor changes to existing disclosure requirements may be necessary.
Proxy Access The SEC is specifically authorized to prescribe rules and regulations that contemplate shareholder access to the proxy. *Effective Date:* Immediate. *Impact:* • Expect SEC to adopt previously-proposed proxy access rules in coming months, likely effective for 2011 proxy season.

For more information on these or related matters, please contact Scott Spector, Blake Martell and Horace Nash.

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