

## LANDMARK FINANCIAL REFORM BILL SIGNED INTO LAW: CORPORATE GOVERNANCE AND DISCLOSURE PROVISIONS APPLICABLE TO ALL PUBLIC COMPANIES

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The Securities Group at Murtha Cullina is pleased to provide clients and friends with information about topics of interest in the Securities area.

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After almost a year of negotiations and conference committee work, the U.S. Congress passed the most sweeping financial reform legislation to be adopted since the 1930s. The new legislation is designed to institute a wide range of reform measures impacting virtually every corner of our nation's financial markets with a grand purpose – to ensure that the financial system is once again viewed as a responsible, accountable and successful engine of our nation's economy. The legislation was approved by the House of Representatives on June 30, and by the Senate on July 15. President Obama signed the legislation, formally known as the "Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010" (the "Act"), into law on July 21, 2010.

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The Act is a 2,300 page behemoth. Although most of its provisions pertain primarily to the financial services industry, a number of provisions pertain to substantially all public companies that file reports and proxy statements with the Securities and Exchange Commission (the "SEC"). This memorandum briefly summarizes these provisions.

The Act is effective immediately, although most of

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the provisions that pertain generally to public companies have delayed effective dates and/or require the SEC and other specified regulatory agencies and national securities exchanges or associations to promulgate rules and regulations implementing the provisions. **Based on recent comments made by SEC Chairman Mary Shapiro and others, we expect the SEC to move quickly to promulgate final rules implementing a number of the Act's provisions, so that most, if not all, of the Act's new provisions will be fully implemented and in effect for the 2011 proxy season for calendar year companies.**

### Proxy Access

The term "proxy access" refers to the ability of shareholders to nominate candidates for election as directors using the Company's own proxy materials. The issue of proxy access has been under formal consideration by the SEC at various times since 2003. Most recently, the SEC proposed a comprehensive set of proxy access rules under existing statutes in June 2009. The proposal generated a significant number of comments, however, and it received strong criticism from the public company community. Some commenters even questioned the SEC's power and authority to mandate proxy access at all. Section 971 of the Act appears to settle this contention and clear

the way for the SEC to move ahead with its proposed rules. This section, which was effective as of the date of enactment of the Act, expressly authorizes the SEC to adopt rules under which shareholders of public companies will be able to nominate candidates for election as directors of public companies using the company's own proxy materials. It also gives the SEC the power and authority to determine the standards and procedures that must be followed by a shareholder who wishes to nominate a director via proxy access and to exempt certain issuers – likely smaller issuers – from the proxy access requirement altogether.

### Mandatory "Say on Pay" Shareholder Votes

Section 951 of the Act requires public companies to seek shareholder approval of certain executive compensation arrangements (frequently referred to as "say on pay" votes). Section 951 of the Act amends the Securities Exchange Act of 1934 (the "Exchange Act") by adding new Section 14A, which requires that, at a company's first annual meeting (or other meeting for which executive compensation disclosure is required to be furnished to shareholders) occurring after the six-month anniversary of the date of enactment of the Act, two proposals must be presented to shareholders. The first is a non-binding vote to approve the compensation of executive officers, as such compensation is disclosed in the proxy statement under Item 402 of Regulation S-K. The second is a non-binding vote on the frequency of future non-binding votes on executive compensation, which may be taken every one, two or three years. Going forward, the non-binding vote on executive compensation must take place at least once every three years and the non-

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binding vote on the frequency of the votes on executive compensation must take place at least once every six years. These provisions of the Act do not require any rule-making by any regulatory agency. Although it is likely that the SEC will promulgate rules to clarify a number of issues relating to the implementation of the "say on pay" votes (and to exempt certain smaller issuers altogether), we believe that every public company should proceed under the assumption that these votes will be required for the 2011 proxy season for calendar year companies.

New Exchange Act Section 14A also requires that, for any shareholder meeting occurring after the six-month anniversary of the date of enactment of the Act at which shareholders are asked to approve an acquisition, merger, sale, disposition or other change-in-control transaction, the proxy material for the meeting must disclose any "golden parachute compensation" that "is based on or otherwise relates to" the change-in-control transaction. Specific disclosure must be made concerning any agreements with executive officers of an issuer regarding compensation that is based on the proposed change-in-control transaction and the total amounts of such compensation to be paid (and any related conditions to such payment). These agreements and payment amounts must be disclosed to shareholders in a separate resolution subject to a non-binding shareholder vote unless they have already been subject to the "say on pay" vote described above.

Section 951 of the Act provides that all of these "say on pay" votes are not binding on the company or its board of directors and may not be construed to overrule decisions made by the board or the company (such as to forego a merger or undo compensation arrangements related thereto), alter the fiduciary duties of the board or the company, create new fiduciary duties for the board or company, or restrict the ability of shareholders to make suggestions to be included in the proxy materials regarding executive compensation.

### Compensation Committees

Section 952 of the Act amends the Exchange Act to add a new Section 10C, which generally imposes new requirements for compensation committees. This section directs the SEC to promulgate new rules within a year of enactment that require the national securities exchanges and national securities associations to prohibit the listing of any equity security of an issuer (other than certain exempted entities, such as controlled companies and open end investment companies), that do not comply with new independence standards to be drafted by the SEC for members of public company compensation committees. The SEC is directed to include a cure period for listed issuers to come into compliance with the new independence standards for compensation committee members, so as to avoid delisting.

Any member of the compensation committee must both be a member of the board and be "independent" (as such term is to be defined by the SEC). In order to determine whether a member is independent, the national securities exchanges and the national securities

associations shall look at factors including (a) the source of compensation received by a compensation committee member, including whether he or she receives any consulting, advisory, or other compensatory fee; and (b) whether the compensation committee member is “affiliated” (likely to be defined under the SEC’s definition of corporate control) with the company, or one of its subsidiaries or affiliates. The SEC’s rules will permit the national securities exchanges and associations to exempt a relationship from the requirements of being independent in order to serve on the compensation committee.

New Section 10C also addresses the independence of consultants, legal counsel or other advisor who serve compensation committees. Within one year after the enactment of the Act, the SEC must adopt rules directing the national securities exchanges and associations to require that compensation committees consider the independence of a consultant, legal counsel or other advisor when retaining these firms. Section 10C requires the SEC to identify the factors affecting independence, including: (i) the scope of services provided to the issuer by the person who employs the consultant; (ii) the amount of fees received from the issuer by the person who employs the consultant as a percentage of the total revenue of the person who employs the consultant, (iii) the conflict of interest policies and procedures instituted by the person who employs the consultant; (iv) the relationships present between the consultant and the members of the compensation committee, and (v) the amount, if any, of stock of the issuer which is owned by the consultant.

Section 10C also provides that the compensation committee shall have sole discretion as to whether to hire, compensate, and monitor the compensation work of a consultant or other advisor. Committee members do not need to act in accordance with the advice of the consultant and must exercise their own judgment to fulfill their duties as committee members. The SEC’s rules will require that each listed issuer must disclose in any proxy material for a meeting held on or after the first anniversary of the Act’s enactment whether the compensation committee used the services of a compensation consultant and if so, whether there were any conflicts of interest, the nature of such conflicts, and how they were resolved.

### Executive Compensation Disclosures

Section 953 of the Act directs the SEC to adopt rules requiring all issuers subject to the SEC’s proxy rules to disclose, in each annual meeting proxy or consent

solicitation statement, a clear description of the relationship between the compensation actually paid to its “named executive officers” (as reported in the proxy statement under Item 402 of Regulation S-K) and the “financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions.” Also, an issuer must disclose the median of the annual total compensation paid to all employees of the issuer except for the CEO, the annual compensation paid to the chief executive officer, and the ratio of the median employee annual total compensation to that of the CEO.

### Recovery of Erroneously Awarded Compensation

Section 954 of the Act amends the Exchange Act to add a new Section 10D addressing “clawbacks” of erroneously awarded compensation to public company executive officers. The SEC is required to adopt rules that direct national securities exchanges and associations to prohibit the listing of any security of an issuer that does not implement a policy providing: (i) for disclosure of the issuer’s policy on incentive-based compensation that is based on financial information required to be reported under the securities laws; and (ii) that the issuer will recover incentive compensation paid to certain current and former executive officers in the event that the issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws. There will be a three year look back period from the date of the restatement, and the amount of the clawback would be the excess, if any, paid to the executive officers over the amount that the executive officers would have been paid under the accounting restatement. This provision is much more expansive than the Sarbanes-Oxley clawback provisions that apply only to the chief executive and chief financial officers in the event of a restatement due to the “material noncompliance” of an issuer.

### Disclosure Regarding Employee and Director Hedging

Section 955 of the Act amends Section 14 of the Exchange Act to require public companies to disclose in any proxy material for an annual meeting whether an employee or board member (or their designee) is permitted to purchase financial instruments that are designed to hedge or offset any decrease in the market value of an equity security granted to the employee or board member as part of the compensation paid to the employee or board member, or otherwise held, directly or indirectly, by the employee or board member.

### Chairman and CEO Positions

Section 972 of the Act directs the SEC, not later than six months after the date of enactment of the Act, to promulgate rules requiring each public company to disclose in its annual meeting proxy statement why they have separated, or combined, the positions of CEO and Chairman of the Board. In December 2009, the SEC adopted rules requiring public companies to make similar disclosures, so it is not clear whether this provision will extend beyond the existing Item 407 disclosure requirements on this topic.

### Discretionary Voting by Brokers

Finally, Section 957 of the Act amends Section 6(b) of the Exchange Act to require stock exchanges to adopt rules prohibiting member organizations from voting shares held in street name with respect to director elections, executive compensation or any other significant matter (as determined by the SEC), unless the beneficial owner has told the member how to vote the proxy in accordance with his or her voting instructions. This provision effectively codifies and expands the scope of New York Stock Exchange Rule 452, which the NYSE voluntarily enacted during the summer of 2009, and will have the effect of eliminating broker discretionary voting for the “say on pay” advisory votes under new Section 14A of the Exchange Act regarding executive compensation and golden parachutes.

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The foregoing summary is intended to provide an overview of selected provisions of the financial reform legislation recently passed by Congress and signed into law by the President. We intend to prepare and issue additional newsletters in the future addressing other important provisions of the Act applicable to public companies and other participants in the securities market. If you have any questions concerning the scope, application, or implications of the Act, or more specifically, the provisions described above, please contact any member of the Murtha Cullina Securities Practice Group.

The full text of the Act is available at:

[http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111\\_cong\\_bills&docid=f:h4173enr.txt.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h4173enr.txt.pdf)

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