M E M O R A N D U M

To	:	Public Comment File
From	:	N. Sean Harrison Office of Rulemaking Division of Corporation Finance
Re	:	Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
Date	:	October 5, 2010

On October 4, 2010, Felicia Kung, Anne Krauskopf, Tamara Brightwell, Lillian Brown, Jennifer Zepralka, Sean Harrison, Scott Hodgdon, and Nandini Acharya of the Division of Corporation Finance met with Gary Brown, Lauren Anderson, Linda Crouch, Sam Chafetz, Beverly Gates, and David Rievesch of the law office of Baker, Donelson, Bearman, Caldwell & Berkowitz ("Baker Donelson") to discuss implementation of Sections 951 through 954 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The representatives of Baker Donelson provided an agenda which is attached hereto.

Attachment

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MEMORANDUM

TO: United States Securities and Exchange Commission

FROM: Baker, Donelson, Bearman, Caldwell & Berkowitz, PC

DATE: September 24, 2010

RE: Agenda for Meeting with Commission Staff on October 4, 2010 Regarding Executive Compensation Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")

Advisory Vote on Executive Compensation. Dodd-Frank Section 951 adds Section 14A to the Securities Exchange Act of 1934 (the "Exchange Act"). Section 14A(a)(1) requires, beginning with meetings held after January 21, 2011 that companies submit at least once every three years for an advisory vote by shareholders ("Say-on-Pay") the compensation of executives, as disclosed pursuant to Item 402 of Regulation S-K. Section 14A(a)(2) further requires that not less frequently than once every 6 years, a separate resolution be submitted to an advisory vote of shareholders to determine whether votes referred to in the preceding sentence will occur every one, two or three years. Section 14A(e) goes on to provide that the Commission may, by rule or order, exempt an issuer or class of issuers from the preceding requirements.

Given the broad authority of the Commission to exempt issuers or classes of issuers from the requirements of Section 14A as well as the Commission's authority to define terms and clarify provisions of the U.S. federal securities laws, consideration should be given to the following:

- Provide that the submission of Say-on-Pay and/or frequency of Say-on-Pay votes do not require the filing of preliminary proxy materials.

- Exempt any issuer that is including a Say-on-Pay in its proxy materials from having to include any shareholder proposal under Rule 14a-8 that relates to the same subject matter.

- Exempt any issuer that commits to an annual Say-on-Pay vote from the second requirement to submit to shareholders a vote on the frequency of the Say-on-Pay vote unless the issuer later changes its intention to submit a Say-on-Pay to every other year or every third year.

- Clarify whether issuers may propose a specific frequency, *e.g.*, the sooner of every three years or the year after the Say-on-Pay vote receives less than a specified level of favorable votes (e.g., 51% or some higher level); and if that proposal is approved, then exempting that issuer from the second requirement to submit to shareholders a vote on the frequency of the Say-on-Pay vote unless the issuer later varies from the "approved" frequency.

- Clarify whether the "say-on-parachute payment" votes required by Section 14A(b) would be required only when the issuer adopts new or materially different parachute arrangements for named executive officers at the time of the change in control or subsequent to an earlier Say-on-Pay vote.

- Clarify that despite the use of the words "to *approve* the compensation of executives," and "separate resolution subject to shareholder vote to *determine*" in Sections 14A(a)(1) and 14A(a)(2), respectively, that shareholders are not actually approving or determining executive compensation but providing their input on these decisions, which are to be made by an issuer's management. This is consistent with Section 14A(c),which states that the votes are nonbinding.

Independence of Compensation Committee Members and Advisors. Dodd-Frank Section 952 adds Section 10C to the Exchange Act. Section 10C requires disclosure about the role of, and potential conflicts involving, compensation consultants. Section 10C also requires the Commission to direct that exchanges adopt listing standards that include certain enhanced independence requirements for members of issuers' compensation committees. The Commission is also directed to establish competitively neutral independence factors for all who are retained to advise compensation committees. In issuing regulations under new Section 10C, we would note the broad authority of the Commission under Section 36 of the Exchange Act to exempt issuers or classes of issuers from the requirements of Act as well as the specific mandate in Section 10C(f)(3) to allow exchanges to exempt issuers and classes of issuers from Section 10C's requirements.

In connection with Section 10C's requirements relating to the independence of compensation committee members, consideration should be given whether the enhanced independence requirements for compensation committee members need be as strict as those imposed on audit committee members. For example, Exchange Act Section 10A(m)(3) requires that audit committee members, in order to be independent, may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee, (i) accept any consulting, advisory, or other compensatory fee from the issuer; or (ii) be an affiliated person of the issuer or any subsidiary thereof. Some *de minimis* exemption should be considered. Also, if a standard similar to that applicable to audit committees is adopted, there should be clarification whether the consulting fees that impair independence include fees paid to companies with which the compensation committee member is affiliated or whether the fees would be required to be paid personally to the compensation committee member.

With respect to Section 10C's requirements relative to the independence of consultants and other advisors, the statute sets forth five factors that should be taken into consideration:

- ***Provision of other services to the company***
  - The Commission should consider a clarification that an issuer's regular outside counsel could be considered independent if that counsel has a direct reporting relationship to an issuer's board of directors or compensation committee. This is consistent with Sarbanes-Oxley Section 307 (and the implementing Commission rules) that provide that the attorneys' responsibilities are to the issuer. An issuer's regular outside counsel often is in the best position to provide insights and information regarding an issuer that would be of assistance to the compensation committee.

- ***Amount of fees as a percentage of total revenue***
  - The purpose of Section 10C is to ensure that that a compensation committee's advisors are independent of corporate management. Therefore, the only concern should be with fees related to services other than those provided directly to compensation committees. For example, even if an advisor were to have only one compensation committee client (and, accordingly, receive all of its fees from that client), that advisor should be deemed to be independent of management because the advisor's services are provided only to that compensation committee. Interpreting Section 10C in this manner also would harmonize Section 10C(b)(2)(B) with the "non-employee director" requirement of Commission Rule 16b-3 and the "outside director" requirement of Treasury Regulations promulgated under Section 162(m) of the Internal Revenue Code, each of which provide that in assessing whether the standards of those provisions have been met, the amount of compensation at issue is the compensation that the director receives from the issuer <u>other than fees paid to him or her in his or her capacity as a director</u>. Accordingly, any regulations should clarify that in assessing independence of a compensation committee advisor, only those fees relating to services provided to a corporation <u>other than fees related to services provided to the compensation committee</u> will be taken into account.
  - Some guideline likely is in order to ensure that one client, even if only a compensation committee, does not dominate an advisor's business. A guideline of 10% is probably fair and reasonable for most. Some multi-year phase-in,

however, should be provided for a newly launched firm in order to prevent potential competitive harm.

- ***Policies and Procedures of the firm designed to prevent conflicts of interests***

    - We support a requirement or clarification that compensation committees and their advisors have robust policies or practices to ensure that there are no relationships between advisors and the compensation committee members or the issuers that they serve that would damage independence and objectivity. These should include:

        - policies regarding gifts and client entertainment expenses;

        - policies regarding the members of the advisor's engagement team providing consulting or other services to the issuer or affiliate or their respective management without the approval of the compensation committee; and

        - policies regarding the advisor's having any affiliation, informal or otherwise, or economic ties with other firms that provide services to management, including compensation or benefit arrangements or fee sharing.

- ***Business or Personal Relationships Between Consultants and Committee Members***

    - Commission rules or guidance should clarify the meaning of "business relationship," which we assume was intended to address business arrangements between an advisor and a compensation committee member (*e.g.*, private investments made with a committee member or an affiliate of a committee member).

    - Because advisors may perform work for multiple compensation committees, and many compensation committee members also serve on other public company boards, it is possible that a consultant could work with the same committee member on more than one client. It is also possible for the CEO of one client to serve on the compensation committee of another client. It would be helpful for a committee to understand if there are other consulting relationships that include the committee members, but we think these types of relationships are only relevant to the extent they damage independence and objectivity. The Commission should provide guidance to address these situations.

- ***Any stock owned by the advisor***

    - We support a requirement or clarification that compensation committees and their advisors have robust policies or practices to ensure that members of the advisor's engagement team or their families do not trade inappropriately (if not banned entirely) in the equity securities of the issuer.

  - Commission rules should clarify factor (E) under Section 10C(b)(2) – "any stock of the issuer owned by the compensation consultant…" – to only mean stock owned by the advising *firm* or by the persons on the engagement team. Additionally, any stock held indirectly, such as through mutual or index funds, should be excluded from any disclosure requirement.

Disclosure of Certain Compensation Matters. Dodd-Frank Section 953 amends Section 14 of the Exchange Act to require disclosure of "the relationship between executive compensation 'actually paid' 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. Section 953 further directs the Commission to amend Item 402 of Regulation S-K to require each issuer to disclose (1) the median of the annual total compensation of all employees of the issuer, except the CEO (or any equivalent position) of the issuer; (2) the annual total compensation of the CEO (or any equivalent position) of the issuer; and (3) the ratio of the amount described in item (1) to the amount described in item (2). Section 953 goes on to require that "total compensation" for purposes of this section be determined in accordance with Item 402(c)(2)(x) of Regulation S-K (*i.e.*, how the amounts set forth in the Summary Compensation Table are determined) as in effect on the day before Dodd-Frank was enacted. In issuing regulations under this portion of Dodd-Frank, we would again note the broad authority of the Commission under Section 36 of the Exchange Act to exempt issuers or classes of issuers from the requirements of Act.

Disclosure of Pay Versus Performance

There are a number of considerations for the Commission in promulgating regulations under this Section of Dodd-Frank, including:

- If this disclosure is to have any purpose and usefulness, there must be some uniformity and comparability among companies. This will require the Commission to prescribe a common set of standards and definitions, including:

  - What compensation will be covered – will it be limited to the named executive officers or to some other group? We submit that the disclosure should be limited to the top five highest paid executive officers (excluding persons who have been terminated as they presumably are not being paid for "performance") for the period in question. Similarly, if the compensation amounts from the Summary Compensation Table ("SCT") for the period in question are to be used, the amounts reflected in the "Change in Pension Value and Non-Qualified Deferred Compensation Earnings" and the "All Other Compensation" columns of the SCT should be disregarded as these amounts generally are not reflective of "performance."

- Because the statute says "actually paid," some adjustments must be made to reflect compensation that executives actually put in their pockets as opposed to the grant date fair values of equity awards that are reflected in the option/stock award columns of the SCT, such as substitution of the payout values of earned performance-based equity grants instead of the grant date fair value of new performance-based equity grants made during the period.

- What is the time period that should be covered? Consideration should be given to making this disclosure mirror that of the performance graph, currently required in the annual report to shareholders (and eliminating that separate performance graph requirement as unnecessary). Alternatively, should issuers be allowed to make multiple disclosures that reflect the performance as it relates to the various plans that may exist – *e.g.*, an issuer may and should discuss a two year plan in context with the related two-year performance of the issuer and the compensation paid under that plan.

- What is the "performance" that is to be measured? Is it to be an issuer's total shareholder return (stock price change plus reinvested dividends) or one or more financial metrics used to determine compensation payouts? May it include non-GAAP financial measures?

Disclosure of Pay Ratio

Without question, this has the potential to be one of the more burdensome to calculate and least useful disclosures not only under Dodd-Frank but under the federal securities laws without significant Commission rulemaking or guidance. It will be impossible, for example, (if this is a goal) to reliably compare ratios between issuers. Issuers in different industries or different geographic areas (including those issuers with significant overseas operations) will pay their employees at different levels.

If read literally, total compensation under this requirement must be calculated in accordance with the requirements of the proxy rules for the SCT used to determine total compensation. This is a calculation that is not normally performed for individual employees other than the named executive officers. It includes elements of pay, such as the annual change in pension value and the value of perquisites (unless the total is under $10,000), that are likely to be burdensome and costly to calculate when applied to a company's entire workforce, rather than to a handful of senior executives. Also note that this section of Dodd-Frank refers to the SCT rules on the day before the law's enactment (July 20, 2010); therefore, without more, future changes to those rules would require companies to perform two sets of calculations for named executive officers.

This new section further requires this calculation for "all employees of the issuer." On the presumption that "all means all," the inclusion of foreign-based and part-time employees poses a number of issues. For example, the inclusion of foreign-based employees will require data that may not be available as well as the need for currency conversions. Given that pay and benefit levels vary dramatically from country to country based on a number of factors, it is unclear how useful this information will be to investors. As to part-time employees, will they be excluded or will their compensation be annualized? Even annualized, they almost certainly will be paid less (and depending on what is included in compensation, be ineligible for certain benefits) than full-time employees; accordingly, their inclusion will likely skew the ratio. Are employees of the issuer's subsidiaries and other affiliates to be included in the calculation? Finally, to calculate the ratio, the employee group will have to be fixed as of a particular date. Section 953 does not specify a date; however, the last day of the prior fiscal year would seem to be an obvious choice. Nevertheless, without some of the simplifying rules or guidance that we suggest, that date might not allow enough time to gather the necessary data and perform all the required calculations.

Section 953(b) further provides that the disclosure must be included in any filing described in Section 229.10(a) of Regulation S-K, which covers not only proxy filings, but registration statements, going-private transaction documents and quarterly and annual reports, among others. In multiple filings over the course of a year, would issuers be required update the ratio each time?

Finally, Section 953's requirement to calculate the *median total pay* for all employees other than the CEO is problematic, burdensome and perhaps impossible for many issuers. Perhaps Congress did not mean specifically to require "median", instead meaning "average." This is extremely important as calculation of <u>median</u> employee pay requires the calculation of *each employee's* pay (however employee and pay are defined), and then ranking them from highest to lowest. The median is the specific employee's pay which is exactly halfway between the top and the bottom. Surely that can not have been Congress' intent and it illustrates the burdensome nature of this disclosure if interpreted in this fashion, particularly for issuers with tens if not hundreds of thousands of employees.

Accordingly, in drafting the rules relative to Section 953, we offer the following considerations:

- Clarify whether the in calculating the ratio and the prospective disclosure whether the CEO's pay is the numerator or the denominator.

- The Commission should consider deferring disclosure of the CEO pay ratio for at least a year to the 2012 proxy season in order to allow issuers to prepare for what all agree will be a burdensome process to prepare this disclosure. In addition, if the Commission does see fit to fix a date for determination of the employee group, that date should be established with a view toward allowing sufficient time for issuers (particularly those with large numbers of employees) to gather and process the required information by the filing due date.

- The Commission should interpret Section 953 narrowly and require the CEO pay ratio disclosure only in proxy statements sent in connection with annual or special meetings at which directors are elected.

- In order to further address the potential administrative burden that issuers will face in complying with this requirement, the Commission should consider, among other things:
  - Allowing issuers to use the ***average*** total compensation per full-time employee instead of **median** pay for all employees,
  - Allowing the exclusion of benefit costs, training, relocation, and similar matters that while technically are "compensation" do not address the spirit of the law and, instead focusing on wages/salaries/overtime, and equity awards,
  - Permitting the use of only full-time employee equivalents and excluding part-time and seasonal employees, and
  - Allowing the exclusion of foreign-based employees and employees in partially owned subsidiaries (including joint ventures).

Clawbacks. Dodd-Frank Section 954 adds Section 10D to the Exchange Act to require the Commission to direct the exchanges to prohibit the listing of securities of issuers that have not developed and implemented compensation claw-back policies. Key differences between the clawbacks envisioned by Dodd-Frank and those that many issuers already have in place in response to Sarbanes-Oxley Section 304 are that (i) the new law requires clawbacks without any misconduct on the part of the executive, (ii) there is a three year as opposed to a twelve month lookback period, (iii) it applies to "current and former executive officer[s]", and (iv) it appears to afford issuers no discretion as to whether to enforce the clawback.

No doubt the Commission will receive and consider all of the policy issues (*e.g.*, timing of implementation, potential skewing toward less incentive and more guaranteed compensation) that will affect its rulemaking under Section 10D. In issuing regulations under new Section 10D, we would again note the broad authority of the Commission under Section 36 of the Exchange Act to exempt issuers or classes of issuers from the requirements of Act and would submit the following considerations for the Commission in its rulemaking:

- The Commission must address how the new clawback disclosure will relate to that already required in an issuer's Compensation Discussion and Analysis.
- The Commission will need to establish an effective date to determine whether issuers' clawback policies under Dodd-Frank must apply to any former executive officers, including those who departed before the law's effective date (July 21, 2010). Such an effective date is a fundamental question. Are existing agreements grandfathered? SEC guidance will be needed on these and a host of related effectiveness/transition issues.
- Section 10D says the new clawback policy will apply to "executive officers." Will the clawback policies cover Section 16 officers or the much narrower "named executive officer" group in the proxy statement? How are persons who are executive officers during only a portion of the time in question to be dealt with?

- Only the Commission may enforce clawbacks under Sarbanes-Oxley Section 304. Section 10D appears to contemplate the issuer being required to enforce its clawback policy. Who may make the decision whether to seek the clawback? In this regard, will issuers or their Boards have discretion in enforcing the clawback policy? Under the TARP guidelines, for example, issuers are not required to enforce a clawback if to do so would be unreasonable. Dodd-Frank is silent on this issue. Similar to a derivative claim, the Commission could decide that issuers should be permitted wide discretion in exercising their clawback rights.

- A gating question for issuers is the question of what constitutes material noncompliance. Clearly, Dodd-Frank envisions that not all restatements are created equal; accordingly, not all would require a clawback. Much like the issue above of who can enforce the policy, the question whether there was material noncompliance also would appear to be an issue that should be left to the determination of the issuer.

- Section 10D provides that the compensation subject to recovery is measured for the three-year period before the restatement is “required.” Does this mean that that if in 2011 that an issuer is “required” to restate its 2007, 2008 and 2009 financials, the clawback would apply to compensation paid for 2008, 2009 and 2010 since those were the three years prior to the restatement being “required”? Would the clawback be on an after-tax basis? Will gains earned on those stock options be clawed back, or will the Commission create a narrower rule that ties the amount to be clawed back directly to the erroneous financial statement? For example, how would incentive compensation based upon a non-financial metric (*e.g.*, safety, customer satisfaction) be dealt with?

- May issuers indemnify (or under state law be required to indemnify) executives whose compensation is clawed back due to no fault of their own. Note that even should the Commission lack the authority to prohibit such indemnifications, issuers would still be required to disclose these agreements in their proxy materials and other filings.

- In a merger, should executives of the acquired entity have some period of time during which they would be excluded from application of the acquiror's clawback policy. May these and similar situations be dealt with in the issuer's clawback policy?