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September 11, 2015

VIA SEC Website

Attn: Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Listing Standards for Recovery of Erroneously Awarded Compensation; File Number S7-12-15

Dear Mr. Fields:

I, Plamen Kovachev - a student of New York Law School, appreciate the opportunity to provide comments to the Securities and Exchange Commission (the "SEC" or "Commission") in response to the proposed new rule and form amendments to implement the provisions of Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which added Section 10D to the Securities Exchange Act of 1934[1]. Among other things, the proposed rule and rule amendments would direct the national securities exchanges and national securities associations to establish listing standards that would require each issuer to develop and implement a policy providing for the recovery, under certain circumstances, of incentive-based compensation based on the restatement of financial information required to be reported under the securities laws that is received by current or former executive officers, and require the disclosure of the policy. A listed issuer would be required to file the policy as an exhibit to its annual report. I fully support the SEC's efforts to adopt rules directing the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with Section 10D's requirements for disclosure of the issuer's policy on incentive-based compensation and recovery of incentive-based compensation previously received when an issuer is required to restate its financials. However, as discussed below, the clawback newly proposed rules are especially deserving of scrutiny and the proposed comment updates because they apply to all publicly listed companies and impose the harsh penalty of mandatory delisting [2].

1. The proposed rules should be modified to include not only provisions containing financial restatement but also ethical misconduct triggers

The popularity of clawback policy disclosure continues to grow. From 2006 to 2013, the percentage of Fortune 100 companies with publicly-disclosed clawback policies increased from 17.6% to 89.4%. Many of these policies allow companies to recover compensation in the event of a financial restatement or ethical misconduct. The majority of clawback policies focus on multiple recoupment triggers. Of the Fortune 100 companies that disclosed clawback policies as grounds for recoupment of compensation, 85.4% included materially inaccurate financial statements and 81.6% included ethical misconduct triggers. In addition, 29.1% of the policies included non-compete violations as triggers and 27.2% had other forms of triggers. [3] For example, American Express has a typical pre-Dodd-Frank clawback policy that recoups compensation when one of 590 covered employees globally engages in "detrimental conduct" that "includes but is not limited to termination of employment for misconduct, working for certain competitors, soliciting company customers or employees for a period of time after termination, or disclosing confidential information."[4] This is a standard "bad boy" provision that most companies include in their compensation agreements with covered employees. In addition to the standard "bad boy" provision, the American Express board of directors also has the discretion to clawback:

> "[P]erformance-based compensation from any executive officer and certain other members of senior management in those circumstances when: the payment of such compensation was based on the achievement of financial results that were subsequently the subject of a restatement; and in the board's view, the employee engaged in fraud or misconduct that caused or partially caused the need for the restatement, and a smaller amount would have been paid to the employee based upon the restated financial results. Also, the cash portion of the CEO's Annual Incentive Award is subject to clawback at the discretion of the Compensation Committee if the company does not achieve acceptable performance in the following year." [5]

By combining both the "bad boy" provision and the accounting restatement as a result of misconduct triggers, American Express has a typical pre-Dodd-Frank clawback policy that is consistent with enforcing an executive's fiduciary duties under state law and encompasses conduct that would be covered by the claw-back provisions in Sarbanes–Oxley Act ("SOX"). It is clear that the mandatory new clawback requirements of Dodd-Frank will slow the recent trend of privately agreed upon clawbacks as companies instead rely on meeting just the minimum requirements of the statute as a substitute for developing their own policies, and some of the beneficial features of already existing policies will be "diluted" or disappear altogether. For example, American Express indicated that “the Dodd-Frank legislation mandates regulation to add additional clawback requirements, and the company will take appropriate steps to implement the final requirements under this legislation.”[5]

Similarly, Wal-Mart’s executive compensation clawback is a good example of how companies have been innovative in designating what types of conduct will trigger a clawback. Wal-Mart’s policy states:

> “• Our cash incentive plan states that a participant must have complied with Walmart’s policies, including our Statement of Ethics, at all times in order to be eligible to receive an incentive payment. Moreover, a participant must repay an incentive award upon demand if the Compensation, Nominating and Governance Committee (“CNGC”) determines within twelve months of its payment that prior to the award’s payment the participant violated any of our policies or otherwise committed acts inimical to the best interests of our company.
>
> • Our Stock Incentive Plan provides that if the CNGC determines that an Associate has committed any act detrimental to the best interests of our company, he or she will forfeit all unexercised options and unvested Shares of restricted stock and performance shares.
>
> • When an Executive Officer leaves Walmart, we generally enter into a separation agreement that states “[t]he Associate . . . acknowledges that the Associate has complied with the applicable Statement of Ethics during the Associate’s employment. The discovery of a failure to abide by the Statement of Ethics, whenever discovered, shall entitle Walmart to suspend and recoup any payments paid or due under this Agreement or any other agreements between the parties.”

> Our Statement of Ethics, among other directives, forbids all Associates from being dishonest, acting illegally, and having conflicts between the Associate's work and personal affairs."[15]

By requiring its executive officers to comply with its Statement of Ethics, Wal-Mart has selected a trigger that goes above and beyond the accounting restatement and that requires officers to rigorously monitor their own conduct. Innovative triggers such as Wal-Mart's support the proposition that the Commission should initiate rules that give maximum freedom to corporations to determine what events will constitute grounds for recovery of compensation. To ensure that clawback policies have *some* teeth, the Commission should modify the new rules to specify a trigger at least as rigorous as accounting restatement, while still allowing companies to go above that standard when they determine that their goals and objectives are best met by imposing more rigorous standards of conduct on their executives.

Thus, to preserve an important component of the current clawback provisions and to closely align the new rule with an executive's fiduciary duties under state law, I propose that the Commission specifically to include language in the rules containing not only provisions of financial restatement but also ethical misconduct triggers, so that issuers do not just default to just meeting the minimum requirements of the new rule.

2. The proposed rules should be modified to be more specific on how to determine the type of damages that are recoverable

The complex nature of executive compensation - which may include cash bonuses, restricted share units, stock options, warrants and deferred compensation plans - makes it very difficult to determine the type of damages that are recoverable under the proposed rules. Most of the problems in determining recoverable damages arise in connection with the determination of what was received during the clawback period. Some examples include:

- Restricted share units that are issued before the clawback period, but vest during the clawback period.
- Stock options that are "in the money" before the clawback period.
- Payouts from deferred compensation programs when the sums deferred were earned well before the clawback period, but were paid during the clawback period.

These problems are only further exacerbated in the case of a long-serving executive, who was issued incentive-based compensation well before the date of the misstated financials. The lack of case law that interprets the new provision and the current language of the rules leave many open questions in terms of the measure of recoverable damages.

Additional problems arise when trying to determine what constitutes "profits" from the sale of securities. For example, if the executive receives 100 shares of stock at $30 per share and the value increases to $40 per share before the clawback period, while the executive ultimately sells the stock during the clawback period for $50 per share, what would be the proper basis? While the Commission may argue that $30 per share is the proper basis, one could certainly argue that $40 is the appropriate measure. These issues are complicated even further in instances where the shares were obtained via the exercise of an option or issued to an executive long before any accounting issues arose. Due to the fact that many of the SEC's prior cases over other clawback rules are filed as settled actions (without a clear indication on how settlement amounts were determined) and none of the previous cases has gone to trial, and that coupled with the unspecific language on damages determination in the current version of the new rules, it is extremely difficult to determine how the damage amounts will be calculated. I propose that the Commission in the revised rules to include specific details about all situations where they apply and example calculations addressing the above mentioned or other similar scenarios.

3. The proposed rules should be modified to allow private right of actions

The federal government's first attempt to mandate executive compensation clawbacks was section 304 of SOX. Looking at the plain language of section 304 is instructive because the text leaves several questions unresolved that Dodd-Frank section 954 has also left unanswered. For example, the SEC had to established through case law that only the SEC has the power to enforce the requirements of SOX section 304, and thus, there is no private right of action.[6] Because Congress did not explicitly authorize a private right of action, appellate courts interpreted section 304 by searching congressional intent for an implied authorization of a private right of action and so far have found no such authorization.[7] Under current law, the SEC enforces its section 304 power (1) by seeking a court order requiring the CEO and CFO to repay compensation, as was the case in *Digimarc*, or (2) by seeking a preliminary injunction enjoining defendants from committing future violations of section 304 when such an injunction would require the executive to pay back the money promptly to avoid running afoul of the statute.[8] In any event, the shareholders get the same result they could achieve if they had their own private right of action, except that under current law, they must wait for the SEC to bring an enforcement action.

The SEC has also established that because only it has the power to enforce section 304, private parties cannot settle litigation by releasing CEOs and CFOs from liability.[44] In *Cohen v. Viray*, the Second Circuit, at the behest of appellant-intervenors, including the Department of Justice and the SEC, disallowed a derivative litigation settlement in which shareholder-plaintiffs released the defendant CEO and CFO from section 304 liability.[45] The settlement was also interesting because it attempted to indemnify the CEO and CFO from section 304 liability in subsequent suits brought by third parties.[46] After settlement, the United States filed objections to the settlement, principally on the grounds that the settlement (i) limited the remedies available to the government in pending criminal cases against the individual defendants and (ii) undermined efforts by the SEC to hold the individual defendants liable for disgorgement under section 304.[47] The SEC cited no authority for the proposition that the indemnification agreement was against the law, and the statute itself certainly does not make such an agreement illegal.[48] By arguing that the agreement was illegal, the SEC took away contract authority from the shareholders and the independent members of the board, the very parties for whose benefit section 304 was enacted. The rigid application of section 304 and the decision to void the indemnification provision honored neither the business judgment of the directors nor the share-holders' view of their own interests. Dodd-Frank section 954 similarly interrupts this process by mandating policies, the details of which will be decided either by the stock exchanges or the SEC itself rather than by the parties to the actual contracts. It is not sound corporate governance policy to continually allow the federal government or its designees to decide the rights and powers of shareholders and directors. This is especially true in situations, as in the case of compensation clawbacks, in which state law already provides methods for reaching the policy outcome the federal government deems desirable.

The facts and examples in the previous two paragraphs underscore the point that shareholders are probably better served by the company-adopted clawback policies, such as the American Express policy discussed above [9] and that under the newly proposed rule, the Commission should explicitly state in the rule language that shareholders would be allowed a private right of action which in turn will ensure more timely resolution of any matters involving a clawback of executive compensation, and will not interfere with the business judgment of the directors and the share-holders' view of their own interests.

4. The proposed rules should be modified to not create incentives to limit performance-based compensation

Because the new rule places incentive-based compensation for executive officers at risk of clawback regardless of whether those officers participated in any wrongdoing, such officers are likely to demand some form of protection from the increased risk and uncertainty surrounding their pay. One response would be to demand higher base compensation, which would not be explicitly subject to clawback under the proposed rule. The amount of base pay awarded would be somewhat limited by the tax deductibility cap in § 162(m) of the Internal Revenue Code, which limits the amount of deductible compensation at $1,000,000 but exempts performance-based pay from the cap.[10] One way to avoid section 954 and the tax consequences of § 162(m) would be for executives to have performance-based pay determined by metrics not covered by section

954. By its own language, section 954 only triggers clawbacks when "financial information" subject to SEC reporting requirements needs to be restated.[11] By way of illustration, suppose a senior executive of Coca Cola's demands that her bonus payments be tied to the number of Sprite cans sold in emerging markets. This data needs not be disclosed under SEC reporting requirements and thus would not trigger a clawback no matter how inaccurate the internal reporting of such numbers may be. A similar result could occur if bonus payments were tied to largely subjective factors, such as increases in customer satisfaction surveys. These examples illustrate both the limited reach of Dodd-Frank section 954 and the strong incentives that it creates for directors to seek performance-based pay on metrics that lack transparency to shareholders. In sum, the less effective the bonus requirements are, the greater the protection they offer from SEC-imposed mandatory clawbacks.

Under 12 U.S.C. § 5221(b)(2)(B) (subsequently amended), the Secretary of the Treasury required TARP recipients to adopt "a provision for the recovery by the financial institution of any bonus or incentive compensation paid to a senior executive officer based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate."[43] The point made in the previous paragraph is further illustrated by the first and perhaps only instance of an executive being forced to forfeit a bonus because it violated TARP compensation clawback rules that had nothing to do with accounting restatements under § 5221, and was only triggered because of a bank merger that involved a TARP recipient with outstanding obligations.[12] The $2 million clawed back in that instance should not have prompted cheers from government authorities or shareholders, because the company answered the bonus clawback by increasing the base salary of the executive by 25%.[13] This state of affairs hardly seems an improvement over existing law, and thus the proposed rules should be modified to not exclusively focus on financial/accounting information, as discussed in first comment above, to prevent creating situations where performance-based compensation is limited.

5. The proposed rules should be modified as the current language creates an incentive for employees not to report potential accounting errors

Federal compensation clawbacks are intended to prevent securities fraud and disclosure misstatements by putting officers on notice that such conduct will have individual financial costs. As the court in *Jenkins* said, SOX section 304 "provides an incentive for CEOs and CFOs to be rigorous in their creation and certification of internal controls by requiring that they reimburse additional compensation received during periods of corporate non-compliance regardless of whether or not they were aware of the misconduct giving rise to the misstated financials."[14] While this policy makes sense for CEOs and CFOs with direct access to financial data generated by their company and who have control over those individuals responsible for such data, other executives are covered by Dodd-Frank section 954. These executives include those who do not have access and control sufficient to encourage compliance, thus subjecting their compensation to clawbacks has no deterrent effect on accounting misstatements.

In fact, the mandatory clawbacks actually create an incentive for employees to not report potential accounting errors. For example, under the SOX clawback regime, an executive who discovered accounting problems faced no personal repercussions for reporting those discrepancies. Under Dodd-Frank section 954, however, that executive would expose his own compensation to clawback by reporting the potential accounting problem. This is another example of how section 954 creates incentives that undermine the very policy goals purportedly advanced by the legislation and thus the Commission should tailor the new rules language to avoid or at least mitigate that result.

6. The proposed rules should be modified to require a causal relationship to exist between the executive actions and the restated financials

There is also a question as to what causal relationship must exist between the "misconduct" and the restated financials. Several courts have noted, in other contexts, that the term "as a result of" means "caused by."[16] For example, in *Murakami v. United States*, the Court of Federal Claims explained: "The ordinary meaning of the noun 'result' is 'something that results as a consequence, issue, or conclusion."' Consistent with this usage, the phrase 'as a result of' has, in various and sundry contexts, been construed to mean 'caused by."'[17] Similarly, in *Black Hills Aviation, Inc. v. United States*, the Tenth Circuit noted that "as a result of" implies a stronger causal link than simply "related to" or "connected with."[18] This analysis is important because in most restatements a team of accountants will scour the books and the increased scrutiny results in the restatement of several items that have nothing to do with the "misconduct" at issue. In some instances these additional items can actually eclipse the items that are being restated due to alleged misconduct. Thus, it may often be inequitable to force an executive to reimburse the company for all incentive-based compensation in such instances and the Commission should take that into account when the new rules are finalized.

7. The Commission's enforcement of the new rules might raise constitutional concerns

To use what we have learned from prior clawback provisions such as Section 304, we know if the SEC's use of Section 304 in the case of innocent executives renders it a grossly excessive penalty, it would clearly be a violation of the Due Process Clause.[19] The government has a legitimate interest in "punishing unlawful conduct and deterring its repetition," but it does not have unbridled discretion in such manners and is limited by constitutional restraints.[20] The Due Process Clause regulates penalties by imposing "substantive limits beyond which penalties may not go."[21] When a punishment is "grossly excessive, it furthers no legitimate purpose and constitutes an arbitrary deprivation of property."[22]

If the SEC enforces Section 304 against executives in the absence of personal misconduct, it undoubtedly imposes a penalty because the relief afforded by Section 304 is not limited to remedial purposes.[23] Courts have held in other securities actions that require a defendant to forfeit anything more than the amount obtained as a result of an individual's wrongdoing results in punitive damages.[24] Indeed, in *SEC v. Microtune, Inc.*, the Northern District of Texas held that the "absence of a link between the amount of reimbursement and the actual harm caused by the defendant weighs in favor of characterizing Section 304's reimbursement remedy as a penalty."[25] Additionally, the fact that the SEC has pursued Section 304 relief against only a handful of purportedly innocent executives--such as Jenkins, O'Dell, McCarthy and O'Leary - since the statute was enacted in 2002 buttresses the arbitrary nature of the Commission's claims. Thus, it is important to address some of the above constitutional issues surrounding Section 304 and carried over the currently proposed rules under Section 954 so that these issues cannot be used as defense before a court in the case of an innocent executive.

8. The proposed rules requirement of material noncompliance before reimbursement is necessary and will result in an automatic clawback of some amount anytime there is a restatement

Neither Sarbanes-Oxley, nor any other federal securities law, defines the term "misconduct" as it is used in Section 304 or gives any guidance as to how egregious the conduct must be to constitute "misconduct." However, because every restatement, by definition, corrects some mistake, error, or discrepancy in a company's accounting statements, the term "misconduct" must mean something more severe than good-faith mistakes and errors, lest the term be read out of Section 304 and rendered meaningless.

In comparison to the SEC's clawback powers under Section 304, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 mandate the issuers to develop their own clawback program. Section 954 states:

> 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, the issuer will recover from any current or former executive officer of the issuer who received incentive-based compensation (including stock options awarded as compensation) ... based on the erroneous data, in excess of what would have been paid to the executive officer under the accounting restatement.[26]

Significantly, Section 954 only requires "material noncompliance" before reimbursement to be necessary, whereas Section 304 contains the presumably higher standard of "misconduct" before a clawback action will be instituted. Unfortunately, the "material noncompliance" standard will likely result in an automatic clawback of some amount anytime when there is a restatement. The new rules language should be modified to address such situations so they can be avoided.

9. The proposed rules should provide for appropriate procedures for an issuer to have a reasonable opportunity to cure any defects that would be the basis for the prohibition (delisting) before the imposition of such prohibition

The text of Dodd-Frank section 952 begins in a fashion similar to section 954: "The Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any equity security of an issuer ... that does not comply with the requirements of this subsection."[30] Section 952, similar to section 954, deals with executive compensation and Congress's order that the SEC direct the national securities exchanges to engage in rulemaking consistent with Congress's directives. In formulating its rules under section 952, the SEC took into account similar provisions of SOX, which it has also tried to do when formulating rules under section 954.[31] Even though section 952 and section 954 both require the stock exchanges to delist companies that violate these new sections, a crucial difference lies in section 952's language which requires a cure period. Section 952 reads, "The rules of the Commission ... shall provide for appropriate procedures for an issuer to have a reasonable opportunity to cure any defects that would be the basis for the prohibition (delisting) before the imposition of such prohibition."[32] No such cure language exists within section 954, which raises the question whether the clawbacks are mandatory under that section, or whether only the creation of clawback policies is mandatory[33] and thus, I proposed the language should be explicitly included in the final rules under the current consideration.

10. The proposed rules should Clearly Define Incentive-Based Compensation

Section 954 requires that only "incentive-based compensation" to be recouped by companies. Therefore, determining what specific forms of compensation fall into that category will be crucial both for the design of compensation plans going forward and for the enforcement of section 954.[34] The statute does not define this term other than to expressly include stock options.[35] The easiest and most regulatory-consistent way of defining ""incentive-based compensation" would be to borrow the definition from Regulation S-K, Item 402(a)(6)(iii), which defines an "incentive plan" as "any plan providing compensation intended to serve as incentive for performance to occur over a specified period, whether such performance is measured by reference to financial performance of the registrant or an affiliate, the registrant's stock price, or any other performance measure."[36] That definition should be applied when determining what compensation is subject to clawback, except that incentive-based compensation must be based on "financial information" under section 954, so that compensation whose amount is determined by references to metrics such as market share or customer satisfaction levels would not be subject to clawback (see comment 4 above).

The most important consequence of using this definition would be to exclude discretionary bonuses from being subject to clawback. Since those bonuses are already discretionary and may not be directly tied to financial information, subjecting them to the Dodd-Frank clawback rules would be an impermissible broadening of the statute. Such discretionary bonuses appear in column D of the Summary Compensation Table required to be disclosed under Regulation S-K, Item 402(c)(2)(iv) and not under the incentive-based columns.[37] Using the Summary Compensation Table as a guide for clawback purposes, only compensation in the “non-equity incentive plan compensation” column should be subject to clawback since the column includes “the dollar value of all earnings for services performed during the fiscal year pursuant to awards under non-equity incentive plans as defined in paragraph (a)(6)(iii) of this Item, and all earnings on any outstanding awards.”[38] To capture equity awards, rulemaking under section 954 should also reference compensation disclosed on the “Grants of Plan-Based Awards” table in the “Estimated Future Payouts Under Equity Incentive Plan Awards.”[39] That column discloses “the number of shares of stock, or the number of shares underlying options to be paid out or vested upon satisfaction of the conditions in question under equity incentive plan awards granted in the fiscal year ....”[40] Using these two reference points in the Executive Compensation Discussion and Analysis section simplifies and minimizes the cost of compliance with section 954 by referencing data that issuers already provide and already use as a basis for compensation. The information disclosed in those two columns certainly meets the definition of “incentive- based compensation,” and the SEC should seek to shoehorn other forms of compensation into that definition.

11. The proposed rules’ one-size-fits-all clawback policies can be harmful to corporations and their shareholders

This belief is based on three hopefully uncontroversial assumptions. First, all things being equal, it is more efficient for companies to seek capital in the public market than in the private market. Oftentimes it is difficult to raise capital in the private markets because of a lack of transparency, a limited investor base, risk, and regulatory oversight.

Second, all things being equal, executive compensation should be based on performance, not paid out in fixed sums. This is supported by the fact that, corporate boards of directors increasingly provide compensation packages under which a greater portion of an executive's pay takes the form of contingent compensation arrangements, rather than a guaranteed base salary. Contingent compensation, at least theoretically, introduces an element of risk for the executive. Where an executive receives all or almost all of her salary in the form of a fixed-base salary, she gets that pay regardless of how she or the company performs. Where a significant portion of pay takes the form of performance-based compensation, such as annual bonus plans, stock options, or stock bonus arrangements, that portion of the executive's compensation is at risk dependent upon company and/or individual performance.[42] Third, important company decisions on sensitive matters such as compensation should be made by the board of directors, not by outside, disinterested parties such as the federal government. Major stock exchanges currently do not have rules in place mandating specific compensation policies such as clawbacks, so Dodd-Frank section 954 creates entirely new obligations for listed companies.[27] Stock exchange rules reflect the same principles as state corporate law. Both recognize that directors, not shareholders or the federal government, are responsible for determining executive compensation.[28] For example, the Nasdaq compensation committee rules are “intended to provide flexibility for a Company to choose an appropriate board structure and to reduce resource burdens, while ensuring Independent Director control of compensation decisions.”[29] Some of that flexibility and control is seriously jeopardized by Dodd-Frank section 954.

In light of these assumptions, Dodd-Frank section 954 can be viewed as a misguided policy because it gives private companies an advantage in hiring executives over public companies whose compensation payouts will be subject to clawbacks due to factors that the executive cannot control. Dodd-Frank section 954 creates a strong incentive for executives to seek higher base pay to compensate them for the uncertainty of their incentive-based compensation and thus weakens the link between performance and pay. Finally, the rulemaking pursuant to section 954 may strip boards of directors of their business judgment discretion to decide when and against whom a clawback serves the interests of the company and the shareholders, taking into consideration a multitude of factors that government authorities would not consider. Thus I proposed the language of the new rules to be modified in such a way that it leaves more leeway for the boards of directors of their business judgment discretion to decide when and against whom a clawback serves the interests of the company and the shareholders.

In conclusion, there is no doubt that Dodd-Frank section 954 will have serious consequences on compensation payouts and compensation committee decision-making. Even as the number of accounting restatements has decreased in recent years, if Dodd-Frank section 954 were in place in 2009, executive officers at up to 674 companies would have been subject to the clawback provisions.[41] These provisions certainly serve a useful purpose, and the Commission should be applauded for enacting them as part of its efforts to keep management accountable and properly incentivized. In situations like compensation clawbacks, where Congress has found a need for action but has not detailed the specifics of any policy, the regulations enacted by administrative agencies should be as deferential as possible to the business judgment of the parties tasked with actually enacting the policies, and flexibility should always be protected such that companies can truly act in the best interests of their shareholders without fear of government reprisal. By implementing the above proposed 11 comments, I believe the Commission can achieve some of this deference to the business judgment in its rule setting and improve the overall rule.

Should you have any questions, please do not hesitate to contact me at [redacted].

Sincerely yours,

Plamen Kovachev
JD, Candidate 2016

[1] 73 P.L. 291 (August 17, 2015).

[2] Dodd-Frank section 954 applies to any issuer listing any security on a national securities exchange. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 § 954, 124 Stat. 1376, 1904 (2010). A "national securities exchange" is an exchange registered as such under section 6 of the Securities and Exchange Act of 1934. 15 U.S.C § 78f (2010). There are currently fifteen national securities exchanges registered under section 6(a): NYSE Amex (formerly the American Stock Exchange), BATS Exchange, BATS Y-Exchange, NASDAQ OMX BX (formerly the Boston Stock Exchange), C2 Options Exchange, Chicago Board Options Exchange, Chicago Stock Exchange, EDGA Exchange, EDGX Exchange, International Securities Exchange, The NASDAQ Stock Market, National Stock Exchange, New York Stock Exchange, NYSE Area and NASDAQ OMX PHLX (formerly Philadelphia Stock Exchange). *Exchanges*, SEC (July 26, 2011), http://www.sec.gov/divisions/marketreg/mrexchanges.shtml.

[3] Press Release, Equilar, Inc., Clawback Policy Report (August 22, 2015) available at http://info.equilar.com/rs/equilar/images/equilar-2013-clawbacks-policy-report.pdf.

[4] American Express Co., Definitive Proxy Statement in Connection with Contested Solicitations (Form DEFC14A) (April 30, 2012) available at http://www.sec.gov/Archives/edgar/data/4962/000119312512121814/d302637ddefc14a.htm.

[5] *Id.*

[6] In re Digimarc Corp. Derivative Litig., 549 F.3d 1223, 1233 (9th Cir. 2008) ([W]e conclude that section 304 does not create a private right of action.").

[7] Cohen v. Viray, 622 F.3d 188, 193-94 (2d Cir. 2010) ("The statute makes no explicit provision of a private cause of action for violations of § 304. We therefore presume that Congress did not intend to create one.") (citing Bellikoff v. Eaton Vance Corp., 481 F.3d 110, 116 (2d Cir. 2007)).

[8] *See, e.g.*, Complaint at 43, SEC v. Spongetech Delivery Sys., Inc., No. CV 10-2031 (E.D.N.Y. May 5, 2010), *available at* http:// www.sec.gov/litigation/complaints/2010/comp21515.pdf.

[9] *See infra* p. 5.

[10] 26 U.S.C. § 162(m)(4)(C)(i-iii). It is worth noting that there have been calls in academia to apply the § 162(m) cap to

performance based pay as well in order to force boards to limit the size of CEO compensation. Charles M. Yablon, *Bonus Questions: Executive Compensation in the Era of Pay for Performance*, 75 N.D. L. REV. 271, 303 (1999). If Professor Yablon's proposal were adopted, there would be little reason for a CEO to seek anything other than fixed pay in return for his services, and therefore the link between pay and performance would be severed.

[11] 15 U.S.C. § 78j-4.

[12] Zachary A. Mider, *Wilmington Trust Reclaimed $2 Million From CEO Foley Because of TARP Rules*, BLOOMBERG (Jan. 4, 2011), http:// www.bloomberg.com/news/2011-01-04/wilmington-trust-takes-back-2-million-from-ceo-because-of-tarp-violation.html.

[13] *Id.*

[14] SEC v. Jenkins, 718 F. Supp. 2d 1070, 1077 (D. Ariz. 2010).

[15] Wal-Mart, Definitive Proxy Statement (DEF 14A) (Jun. 7, 2013) available at http://www.sec.gov/Archives/edgar/data/104169/000130817913000238/lwalmart_def14a.htm.

[16] *Murakami v. United States*, 52 Fed. Cl. 232, 239 (2002); *Black Hills Aviation, Inc. v. United States*, 34 F.3d 968, 975 (10th Cir. 1994) (noting that "use of the plain language--'as a result of'--is logically interpreted to mean 'caused by"'); *In re Woodward & Lothrop Holdings, Inc.*, 205 B.R. 365, 372-73 (Bankr. S.D.N.Y. 1997) (finding that the term "as a result of" connotes a causal connection); *Finstad v. Washburn University of Topeka*, 252 Kan. 465, 845 P.2d 685, 689-90 (1993) (holding that "as a result of," as used in a consumer protection statute, suggested a causal link); *John Hancock Mutual Life Ins. Co. v. Serio*, 176 A.2d 874, 875 (D.C. 1962) (holding that the phrase "as a result of" was equivalent to the test of proximate cause).

[17] *Id.* at 239.

[18] *Black Hills*, 34 F.3d at 975.

[19] *See, e.g.*, *BMW of N. Am. v. Gore*, 517 U.S. 559, 569 (1996) (explaining that statutory penalties violate due process where the penalty is "grossly excessive" in relation to the government's interest in deterrence).

[20] *Id.* at 568.

[21] *TXO Prod. Corp. v. Alliance Res. Corp.*, 509 U.S. 443, 453-54 (1993); *see also State Farm Mut. Auto. Ins. v. Campbell*, 538 U.S. 408, 417 (2003) ("The Due Process Clause of the Fourteenth Amendment prohibits the imposition of grossly excessive or arbitrary punishments.").

[22] *Campbell*, 538 U.S. at 417.

[23] *See Austin v. United States*, 509 U.S. 602, 610 (1993) ("a civil sanction that cannot fairly be said solely to serve a remedial purpose, but rather can only be explained as also serving either retributive or deterrent purposes, is punishment, as we have come to understand the term.") (internal quotations omitted).

[24] *See, e.g.*, *SEC v. Cavanaugh*, 445 F.3d 105, 117 n.25 (2d Cir. 2006) (explaining the limits to an equitable remedy before it becomes punitive); *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978) ("The court's power to order disgorgement extends only to the amount with interest by which the defendant profited from his wrongdoing. Any further sum would constitute a penalty assessment.").

[25] 738 F. Supp. 2d 867 (N.D. Tex. 2011) (determining that Section 304 reimbursements are subject to the statute of limitations for enforcement of penalties and dismissing the SEC's argument that Section 304 is purely remedial "because the amount of reimbursement is not limited to the amount of harm caused to the company," nor must it be "causally related to the alleged wrongdoing," but "[i]nstead, Section 304 requires reimbursement of all stock profits and bonuses received within a twelve-month period after specified filings.").

[26] Dodd-Frank Wall Street Reform and Consumer Protection Act § 954, Pub. L. 111-203, H.R. 4173 (2010).

[27] The NYSE Listed Company Manual requires companies to have a compensation committee composed entirely of independent directors, but nowhere does the manual describe the scope or mandate the substance of compensation decisions made by that committee. NYSE Listed Company Manual § 303A.05. Nasdaq rules also require a compensation committee comprised entirely of independent directors, but there are no requirements as to what policies

those committees must adopt and enforce. Nasdaq Rule 5605(d).

[28] DEL. CODE ANN. tit. 8, § 141(h) (2011) ("Unless otherwise restricted by the certificate of incorporation or bylaws, the board of directors shall have the authority to fix the compensation of directors,"), § 122(5) (The corporation, under the direction of the board of directors, is empowered to "[a]ppoint such officers and agents as the business of the corporation requires and to pay or otherwise provide for them suitable compensation."); MODEL BUS. CORP. ACT § 8.01 (2007) ("[A]ll corporate powers shall be exercised by or under the authority of the board of directors"), § 3.02(11) (Corporation has power to appoint employees and "fix their compensation"), § 6.24 Official Comment ("The creation of incentive compensation plans for directors, officers, agents, and employees is basically a matter of business judgment.").

[29] Nasdaq IM-5605-6, Adopted Jan. 11, 2013 (SR-NASDAQ-2012-109).

[30] P.L. 111-203, § 952(a). Section 954 begins, "The Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that does not comply with the requirements of this section." 15 U.S.C. § 78j-4.

[31] *See* Proposed Rule, Listing Standards for Compensation Committees 14, *available at* http://sec.gov/rules/proposed/2011/33-9199.pdf.

[32] 15 U.S.C. § 78j-3(f)(2).

[33] Even though no cure language exists in the statute, the major exchanges already have certain procedures in place that give companies an opportunity to challenge any action to delist their securities. *See, e.g.*, NYSE Listed Company Manual §§ 801-05; Nasdaq Equity Rules 5800 Series; NYSE AMEX LLC Company Guide Section 1009 and Part 12.

[34] 15 U.S.C. § 78j-4(b)(2) (1934).

[35] *Id.*

[36] Regulation S-K, Item 402(a)(6)(iii).

[37] *Id.* at 402(c)(2)(iv).

[38] *Id.* at 402(c)(2)(vii).

[39] *Id.* at 402(d)(1).

[40] *Id.* at 402(d)(2)(iv).

[41] Audit Analytics, *2009 Financial Restatements: A Nine Year Comparison*, (Feb. 2010), *available at* http://www.auditanalytics.com/doc/AuditAnalytics_2009_Restatementseport_02_2010.pdf. In 2009, the aggregate dollar value of net income restatements for Amex, Nasdaq, or NYSE listed companies was $1,072,908,261, which is a large pool of revenue on which to base incentive compensation. *Id.* at 14.

[42] Motivating Executives: Does Performance-based compensation positively affect managerial performance? (1999), available at https://www.law.upenn.edu/journals/jbl/articles/volume2/issue2/Stabile2U.Pa.J.Lab.&Emp.L.227(1999).pdf

[43] 12 U.S.C. §5221.

[44] Cohen v. Viray, 622 F.3d 188 (2d Cir. 2010).

[45] *Id.* Cohen was a case of first impression on the question of whether shareholders can release CEOs and CFOs from § 304 liability. As the Second Circuit said, "We have not, and indeed no court has, yet addressed whether by private agreement parties may indemnify a CEO or CFO against liability imposed by § 304." *Id.* at 193.

[46] *Id.* The settlement provided that "DHB shall indemnify defendants David H. Brooks and Dawn M. Schlegel, and each of them, against any liability under § 304 of the Sarbanes-Oxley Act of 2002 incurred by them, or either of them, in any action brought by a third party under § 304, and to pay to them, and to each of them, an amount equal to any payment made by them, or either of them, to DHB pursuant to any judgment in any such action."

[47] *Id.* at 191.

[48] Brief for Appellee at 17, Cohen v. Viray, 622 F.3d 188 (2d. Cir. 2010) (No. 08-3860-cv), 2009 WL 7481389.