SULLIVAN & CROMWELL LLP

TELEPHONE: 1-212-558-4000
FACSIMILE: 1-212-558-3588
WWW.SULLCROM.COM

125 Broad Street
New York, NY 10004-2498

LOS ANGELES • PALO ALTO • WASHINGTON, D.C.
FRANKFURT • LONDON • PARIS
BEIJING • HONG KONG • TOKYO
MELBOURNE • SYDNEY

September 22, 2015

Via E-mail

Mr. Brent J. Fields,
Secretary,
Securities and Exchange Commission,
100 F Street, NE,
Washington, DC 20549.

Re: Listing Standards for Recovery of Erroneously Awarded Compensation – File No. S7-12-15

Dear Mr. Fields:

We are pleased to submit this letter in response to the solicitation by the Securities and Exchange Commission (the "Commission") for comments on proposed Rule 10D (the "Proposed Rule") under the Securities Exchange Act of 1934 (the "Exchange Act"). The Proposed Rule implements Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") by directing the national securities exchanges to establish listing standards requiring listed issuers to (1) implement policies mandating the recovery or "clawback" of excess incentive-based compensation earned by a current or former executive officer during the three fiscal years preceding an accounting restatement to correct a material error and (2) disclose policies on incentive-based compensation based on financial information required to be reported under the securities laws.[1]

We support the Commission's efforts to protect investors and agree with the intent of the Proposed Rule – that an executive should be required to recoup a portion of his or her compensation if such amounts were calculated based on company performance that is subsequently determined to be misstated. However, we respectfully request that the Commission consider the following recommendations for changes to the Proposed Rule that will ultimately be adopted (the "Final Rule"), as we believe that the formulation proposed by the Commission goes too far with respect to the scope of

[1] Listing Standards for Recovery of Erroneously Awarded Compensation, 80 Fed. Reg. 41144 (July 14, 2015).

executives and issuers subject to the mandatory clawback, but does not go far enough with respect to the level of flexibility and discretion afforded to affected issuers, particularly with respect to fundamental principles of international comity.

1. **The Proposed Rule intrudes on non-US governance authority and standards and is inconsistent with fundamental principles of international comity.**

As we discuss in more detail below, we believe that issuers should be afforded with the discretion to make independent determinations regarding enforcement of clawbacks. However, in all cases, we believe that it is critical that the interaction of the Proposed Rule with non-US law be addressed and urge the Commission to consider implementing a more fulsome conflict of law exception in the event non-US law conflicts with or otherwise restricts recovery.

A. *The Final Rule must provide an express exception for local law (outside of an issuer's home country) that applies to an executive officer outside of an issuer's home country and prohibits clawback.*

The Proposed Rule would limit the scope of the conflict of law exception to the law of a foreign private issuer's home country. However, conflict could arise in any circumstance where an executive officer is resident in or has a place of employment in a jurisdiction whose laws prohibit or otherwise restrict clawback with respect to such persons (for example, if a non-US issuer has an executive officer outside of its home country or if a US issuer has an executive resident in or with a place of employment outside of the United States). Because employment law is often governed by the location of the employee, a limited conflicts of law exception for a foreign private issuer's home country law will not adequately address the issues faced by multinational corporations (including US issuers) with executive officers resident in and performing services in numerous jurisdictions. For this reason, the Proposed Rule would potentially put an issuer in the position of failing to comply with the applicable listing standard or governing local law.

Moreover, just because a jurisdiction does not expressly prohibit clawbacks does not necessarily mean that they will be enforced. For example, a clawback could be deemed to violate the general public policy of a jurisdiction, such as a policy against penalties, which may not be discovered absent litigation. In our view, the Proposed Rule operates in the wrong fashion. With respect to executive officers resident in or performing services outside the United States, the issuer should be required to comply with the clawback policy only if it can receive an opinion of counsel that the clawback will be enforced. Otherwise, the Proposed Rule will, in essence, require an issuer with executive officers resident or performing services in a jurisdiction that does not expressly permit clawbacks to litigate these claims all the way up to the highest tribunal in that jurisdiction.

While the Proposed Rule provides an exception from the clawback requirements in the event an issuer establishes that it would be impracticable to do so, we note that such exception is only available *after* the issuer makes a reasonable attempt to recover the incentive-based compensation and subsequently concludes that the direct expense paid to a third party to assist in enforcing the clawback policy would exceed the amount to be recovered. Such a requirement itself would likely cause the issuer to incur additional expense and does not take into consideration the risk of reputational harm and increased litigation exposure faced by the issuer in jurisdictions where mandatory clawbacks are illegal, unenforceable or untested under local law. The Final Rule should provide an express exception to address these types of conflicts of law, or at the very least, provide issuers with a greater degree of discretion as to whether to pursue recovery in such circumstances. In addition, requiring person-by-person disclosure in this circumstance is inappropriate.

B. Foreign private issuers should be excluded from the Final Rule or at a minimum, the Final Rule should give appropriate deference to a foreign private issuer's home country requirements.

The Commission has a long-standing practice of respecting the governance and related disclosure regimes of other sovereigns. As a non-exclusive list of examples, (1) foreign private issuers are not subject to the proxy or information statement requirements of Section 14 of the Exchange Act (which represent core governance and compensation disclosure and is the location where US issuers will disclose clawback-related information),[2] (2) foreign private issuers are exempt from "say on pay," "say on frequency" and "say on golden parachute" rules implemented under Section 951 of the Dodd-Frank Act,[3] (3) the Commission's final rules for compensation committees and compensation adviser independence implemented under Section 952 of the Dodd-Frank Act allow foreign private issuers to follow home country practice (automatically exempting such issuers from the relevant requirements if on disclosure of significant differences from domestic issuers)[4] and (4) foreign private issuers are similarly exempted from the final pay ratio rules and the proposed pay-for-performance rules under Section 953 of the Dodd-Frank Act.[5] For example, in 2006, when the Commission adopted

2 Exchange Act Rule 3a12-3(b) specifically exempts securities registered by a foreign private issuer from Sections 14(a) and 14(c) of the Exchange Act.

3 Exchange Act Rule 14a-21(a), Exchange Act Rule 14a-21(b) and Item 402(t) of Regulation S-K.

4 Exchange Act Rule 10C-1(b)(iii)(A)(4).

5 *See* Pay Ratio Disclosure, 80 Fed. Reg. at 50104 (August 18, 2015) and Pay Versus Performance, 80 Fed. Reg. at 26330 (May 7, 2015). Foreign private issuers are not required to provide pay ratio disclosure under Item 402(u) of Regulation S-K and as proposed, would not be required to provide pay-for-performance disclosure under Item 402(v) of Regulation S-K, in each case, because

enhanced executive compensation disclosure requirements for proxy statements, registration statements and annual reports filed by public companies, it continued to treat foreign private issuers who complied with the more limited disclosure requirements under Form 20-F as complying with Item 402 of Regulation S-K, stating that this approach "showed appropriate deference to a foreign private issuer's home country requirements."[6]

We believe that the same degree of deference should be afforded to foreign private issuers under the Final Rule, and that adopting prescriptive rules relating to a foreign private issuer's clawback policies could affect the governance structures of foreign entities by "injecting US corporate governance theory into foreign countries via a US listing standard."[7] We agree with fellow commenters that "home countries would generally have a greater interest than the US in determining whether companies should have [clawback] recourse against their executives"[8] and for such reasons, urge the Commission to exempt foreign private issuers from the requirements of the Final Rule, or at a minimum, permit a foreign private issuer to comply with an analogous home country law instead of with the listing standard of the applicable US exchange that lists the foreign private issuer's securities.[9] The latter would be consistent with the compensation committee standards of Rule 10C. Requiring a non-US issuer to comply with US and home country requirements would upset the regulatory framework established by the home country and potentially impose inconsistent standards.

The Commission explains that it is not proposing to exempt categories of listed issuers (including foreign private issuers) from the proposed clawback rule because "the objective of recovering excess incentive-based compensation is as relevant for these

---

securities registered by such issuers are not subject to the proxy statement requirements of the Exchange Act.

6 Executive Compensation and Related Person Disclosure, 71 Fed. Reg. 53158 at 53193 (September 8, 2006).

7 *See* Commissioner Daniel M. Gallagher, *Dissenting Statement at an Open Meeting On Dodd-Frank Act "Clawback" Provision* (July 1, 2015), *available at* http://www.sec.gov/news/statement/dissenting-statement-compensation-clawback-listing-standards.html. ("Commissioner Gallagher's Dissent").

8 See comments related to the executive compensation provisions of the Dodd-Frank Act submitted to the Commission by the Committee on Federal Regulation of Securities of the Section of Business Law of the American Bar Association Letter on September 29, 2010, *available at* http://www.sec.gov/comments/df-title-ix/executive-compensation/executive-compensation.shtml.

9 The Commission itself makes reference to the UK Corporate Governance Code and the EU Capital Requirements Directive, which independently provide variations on clawback-type provisions. 80 Fed. Reg. at 41148.

categories of listed issuers as for any other listed issuer."[10] We believe, however, that consistent with the Commission's well established practice of comity, especially as related to corporate governance and compensation matters, a foreign private issuer's home country rules should govern regardless of whether the issuer has voluntarily listed securities on a US exchange. Moreover, the Commission's position assumes that the clawback required under the Proposed Rule is the only possible way to address clawbacks.

C. *The Final Rule should provide a home country conflict of law exception regardless of when the home country law was enacted and should not require issuers to provide a legal opinion of home country counsel.*

Under the Proposed Rule, foreign private issuers are exempt from mandatory clawback requirements in the event recovering the amount at issue would violate home country law. However, before a foreign private issuer may conclude that recovery would violate home country law, it must obtain an opinion of home country counsel, in a form acceptable to the applicable securities exchange or association, that recovery would result in such a violation. As proposed, this exception would only be available for those laws adopted in the foreign private issuer's home country before July 14, 2015 (the publication date of the Proposed Rule in the Federal Register).

As discussed above, we believe that the Commission should re-analyze this portion of the Proposed Rule and not require a foreign private issuer to pursue a clawback unless in the opinion of counsel the clawback is enforceable under applicable law. As we note above, several laws may apply to an executive officer – laws of the home country of the issuer, laws of the jurisdiction of the executive officer's residence and laws of the country in which the executive officer is providing services. If the Commission does not adopt our proposed approach, we offer the following suggestions.

First, the exception cannot be limited to laws in existence prior to July 14, 2015. Such a requirement in essence pre-empts rule making world-wide. The Commission could not have intended to prevent every other jurisdiction in the world from adopting rules or regulations on clawbacks.

Second, the proposal to limit the exception to laws enacted as of July 14, 2015 essentially requires a foreign private issuer to comply with the laws applicable to it or delist their securities from the applicable US exchange. The is not in the interests of shareholders, US investors or liquidity in the US marketplace. An issuer should not be forced to choose between complying with law and delisting.

---

[10] *Id*. at 41147.

Third, a prerequisite to relying on the exception is providing to the applicable securities exchange or association a legal opinion concluding that recovery by such issuer would violate home country law. This is a very onerous requirement and in practice may be difficult, if not impossible, to meet. Foreign counsel may well be reluctant to provide an opinion to US self-regulatory bodies since that could potentially expose such counsel to the US regulatory regime and related litigation risk, which is inconsistent with the policy rationale behind a conflict of law exception. Moreover, opinion practice varies world-wide and counsel may be reluctant to share opinions with US self-regulatory bodies that have no experience in or understanding of opinion practice in that jurisdiction. For these reasons, we do not believe that an issuer should be required to file a legal opinion with US self-regulatory organizations and would ask that the Commission reconsider the consequences of requiring a legal opinion of non-US counsel.

2. The Final Rule should afford issuers (and their board of directors) greater discretion when making clawback determinations.

As of 2013, 89% of Fortune 100 companies had publicly-disclosed clawback policies and approximately 85% of these clawback policies included materially inaccurate financial statements as grounds for recoupment.[11] While in recent years an increased number of issuers have established clawback policies that take into consideration business strategy, executive compensation design and corporate governance philosophies,[12] under the Proposed Rule, issuers have little to no discretion when it comes to making determinations regarding (1) whether to pursue a clawback, (2) whether to settle a clawback for less than the full amount, (3) whether there is a *de minimis* amount of compensation that is not worth pursuing and (4) whether to recover under an alternative measure.

We note that the Proposed Rule sets forth only one narrow exception under which an issuer can decide against pursuing a clawback – impracticability. For domestic issuers, the measure of whether a clawback is "impracticable" is limited solely to an analysis of cost. Instead of establishing a flat mandate on recoupment, we believe that the Final Rule should provide issuers' boards of directors with discretion to fully assess whether enforcement of the clawback is in the best interest of the issuer and its shareholders. We believe that boards of directors need flexibility in this area to take into account the relevant circumstances of the issuer then existing, including whether recovery

---

[11] *See* Equilar, Inc., *Clawback Policy Report* (2013) *available at* http://info.equilar.com/rs/equilar/images/equilar-2013-clawbacks-policy-report.pdf. ("Equilar Report").

[12] *Id.* at 4, noting that from 2006 to 2013, the number of Fortune 100 companies with publicly-disclosed clawback policies increased from 17.6% to 89.4%.

would cause reputational harm, make recruiting or retaining executives more difficult or costly, or otherwise jeopardize the long-term health or shareholder value of the company.

We believe that affording issuers discretion as to whether to pursue a clawback would be appropriately balanced by the Proposed Rule's requirement that an issuer publicly disclose when it has determined not to pursue recovery and why, together with the amount at issue. If shareholders ultimately disagree with the issuer's decision not to implement recovery, they may vote against those directors when next standing for election or against the issuer's next "say on pay" proposal. For this reason, we would expect that boards of directors would act judiciously with respect to exercising discretion as to clawback determinations, as such actions will undoubtedly be subject to scrutiny from shareholders, proxy advisors and the media.

We also believe that requiring the naming of individuals where an issuer determines not to seek recovery is inappropriate. The specific identity of an executive will in most cases not be material in any way to the evaluation of the board of directors' determination not to pursue recovery. Where the identity is material, the board would be free to include specific identification.

3. **Using the Rule 16a-1(f) definition of "executive officer" subjects a wide range of individuals to the Proposed Rule's no-fault recovery mandate, when such persons may have limited responsibility for the issuer's financial reporting.**

The Proposed Rule would apply to a universe of "executive officers" that is modeled on the definition of "officer" in Rule 16a-1(f) under the Exchange Act. Accordingly, the population of executives subject to the Proposed Rule is broad, as the definition picks up not only an issuer's top executives (president and principal financial officer) but also captures vice presidents in charge of an issuer's principal business units, divisions or functions, as well as any other officer who performs a policy-making function for the issuer. This means that a lower-level executive may, by virtue of the Proposed Rule's "executive officer" definition and no-fault standard, be subject to a mandatory clawback caused by activities outside the executive's control, despite such executive's providing accurate financial information for his or her business unit or segment. It appears to us to be arbitrary and capricious to subject a person to clawback in circumstances where the material error was not in his or her control, could not have been prevented by such person's actions and related to an entirely different business unit or segment.

We agree that it is appropriate for officers with important roles in accounting or finance to be subject to the Proposed Rule's recovery policy, but believe that the Commission could have more appropriately tailored the applicable definition to capture only those executives with responsibility for an issuer's financial reporting. The Commission should reevaluate the scope of executives covered by the Proposed Rule and

reconsider vesting issuers with some degree of discretion to determine, based on the particular facts and circumstances contributing to a financial restatement, which executives caused the material error or had the ability to prevent or correct the material error and should be subject to recovery.

4. **The Proposed Rule's three-year clawback period is overly formulaic and may discourage individuals from serving in interim service in executive officer roles.**

Under the Proposed Rule, clawback would be required for any excess covered compensation received by any person who served as an executive officer during the three completed fiscal years immediately preceding the date on which an issuer is required to prepare an accounting restatement. This strict measure set forth by the Commission does not give sufficient consideration to the realities of interim executive service and does not provide issuers with sufficient discretion to recover amounts on a pro-rata basis, depending solely on the portion of the applicable performance period in which the individual actually served as an executive officer.

It is not uncommon for non-executive officer employees to become executive officers for a limited period of time due to a death, retirement, disability or separation of employment of a current executive officer. Under the Proposed Rule, all of the incentive compensation earned by an individual during the applicable three-year period would be subject to clawback, even where such person's actual service as an executive officer may have been limited to a small portion of such period and where the person's service as an executive officer was intended to be on an interim basis.

The risk of subjecting such compensation to potential clawback could discourage individuals from accepting interim executive officer appointments and ultimately disadvantage issuers who are in need of leadership during periods of transition, crisis or other change. For this reason, we believe the Final Rule should provide issuers with appropriate flexibility to recover on a pro-rata basis for those persons serving as executive officers for only a portion of the applicable three-year look-back period.

* * *

We appreciate this opportunity to comment on the Proposed Rule, and would be happy to discuss any questions with respect to this letter. Any such questions may be directed to Robert W. Reeder, III [redacted]) or Marc R. Trevino ([redacted]).

Very truly yours,

/s/ SULLIVAN & CROMWELL LLP