

(Dodd) Frank Talk

About New Governance and Compensation Requirements

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Dodd-Frank Wall Street Reform and Consumer Protection Act



- Enacted on 7/21/2010
- Principal impact is comprehensive reform of U.S. financial system
- Also includes significant corporate governance and executive compensation reform impacting public companies
- Some new rules are effective for the 2011 proxy season

Governance, Compensation and Other Public Company Aspects of the Act

- Shareholder Advisory Votes on Compensation
 - Say-on-Pay, Say When on Pay, Say on Parachutes
- Whistleblowers and Enhanced SEC Enforcement
- Impact on other SEC disclosure and offering rules
- Many SEC rulemaking projects, including new proxy disclosures
- Proxy Access

Shareholder Votes on Compensation



- **Say-on-Pay** – Non-binding shareholder advisory vote on compensation
- **Say When on Pay** – Shareholder vote on how frequently Say-on-Pay votes should be held
- **Say on Parachutes** – Non-binding shareholder advisory vote on golden parachutes
- SEC Rules (proposed rules expected Oct.-Dec. 2011) **may** exempt smaller companies

Say-on-Pay



- Shareholder non-binding advisory vote on compensation of named executive officers
 - Must hold Say-on-Pay vote at the first shareholders meeting on or after 1/21/11
 - Thereafter, must hold vote at least once every three years as dictated by Say When on Pay Vote
 - Vote to approve (or disapprove) all executive compensation disclosed in the proxy statement, including tables and narrative disclosures
 - No binding impact on Board, agreements, etc.
 - Per Dodd-Frank, no broker discretionary voting

Say When on Pay

- Shareholder vote on whether the Say-on-Pay vote will occur annually, biennially or triennially
 - Must hold Say When on Pay vote at the first shareholders meeting on or after 1/21/11
 - Vote must be held no less frequently than once every six years
 - Mechanics are unclear – will the vote be a plurality vote?
 - Companies may need to amend their bylaws

Say on Parachutes



- Shareholders will have a non-binding advisory vote on so-called golden parachute arrangements for named executive officers
 - Vote will only be held in a special meeting to approve a merger, sale or acquisition
 - Shareholders are asked to approve compensation payable in connection with the transaction, which must be adequately disclosed
 - Only applies to compensation arrangements that were not subject to a previous Say-on-Pay vote (probably only applies to recent arrangements or changes)

Shareholder Votes on Compensation



- How to prepare:
 - Enhance clarity and transparency of compensation disclosure – especially “pay for performance” link
 - Review of compensation practices that may be considered “problematic,” and consider engagement with large shareholders
 - Consider prior investor comments on compensation and/or shareholder proposals
 - Consider what the board should recommend on frequency of vote – annual, biennial or triennial

Accredited Investors and Bad Boys



- ACCREDITED INVESTORS

- Dodd-Frank changed the net worth test for meeting the “accredited investor” standard
 - Treatment of primary residence and the “net worth” test
 - No change to the annual income test for natural person investors
- *Action Item*: If involved in raising or planning to raise capital, you should revise your subscription materials or investment representation letters to obtain new representations justifying your claim to an applicable exemption

Accredited Investors and Bad Boys (cont'd)



- FORTHCOMING RULES ON BAD BOYS
 - Dodd-Frank also requires the SEC to issue rules within the next year disqualifying certain “bad actor” issuers from reliance on the Rule 506 safe harbor offering exemption under Regulation D
 - Expected to be substantially similar to Rule 262: (i) will disqualify issuers that have been subject to an injunction or convicted of a felony or misdemeanor in connection with the purchase or sale of a security; and (ii) will contain other disqualification triggers

Attestation Report Exemption

- Exempts smaller public companies that are not “accelerated filers” or “large accelerated filers” from compliance with the internal control auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act
- Directs the SEC to study ways of reducing the burden of Section 404(b) compliance on companies with market capitalizations between \$75 million and \$250 million
- What does it mean for internal controls?



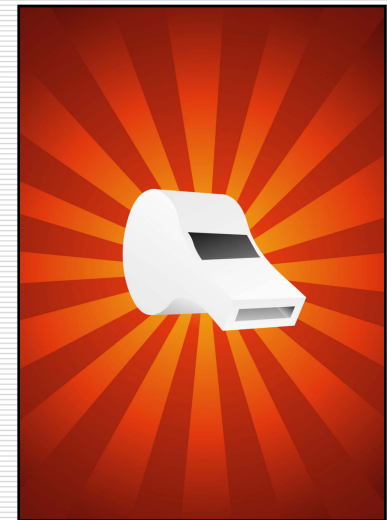


Whistleblower Provisions

- Dodd-Frank establishes monetary awards (a “bounty”) for whistleblowers in any SEC or CFTC enforcement action resulting in a sanction of over \$1 million, with award amounts determined as a percentage of the recovery
- Fundamental shift in government policy from the whistleblower provisions in Sarbanes-Oxley

Whistleblower Provisions (cont'd)

- Requirements: must provide SEC with (1) "original information," (2) "derived from the independent knowledge or analysis of a whistleblower" that (3) "is not known to the SEC from any other source, unless the whistleblower is the original source" and (4) is not exclusively derived from an allegation in a judicial or administrative hearing, governmental report, investigation, etc., or from the news media
- If information results in sanctions over \$1 million, the whistleblower is entitled to an award equal to 10% to 30% of collected amount (SEC has discretion within range)



Whistleblower Provisions (cont'd)

- More whistleblower activity, and more costly retaliation litigation against public companies and financial sector employers, is expected
- *Significant Risks:*
 - Company may lose potential “credit” for self-reporting or cooperating with an investigation — meaning that sanctions may be more likely or more severe
 - Company may lose the opportunity to fully investigate the matter before having to answer to the SEC — while, meanwhile, the SEC is more likely to hear allegations from individuals lacking complete or accurate facts

Whistleblower Provisions (cont'd)

- Dodd-Frank significantly expands anti-retaliation employment protections and remedies for whistleblowers. The new provisions:
 - Extend the statute of limitations from 90 days to six years
 - Exempt whistleblower claims from pre-dispute arbitration
 - Allow whistleblowers to bypass administrative process
 - Clarify that whistleblower claims, including under SOX, can be tried before a jury
 - Provide not only for reinstatement and attorneys' fees, but also double back-pay

Whistleblower Provisions (cont'd)

-Action Items

- Review and update compliance policies annually
- Ensure board oversight of compliance program
- Emphasize importance of legal and regulatory compliance, and ethical conduct
- Consider incentives for internal reporting
- Emphasize that retaliation for reporting legitimate concerns will not be tolerated
- Investigate and evaluate complaints and anonymous reports quickly
- Consider disclosing investigation and company commitment
- Document company's response to each complaint
- Take corrective action where wrongdoing is found
- Consult with counsel experienced in investigations, compliance and enforcement

Enforcement Enhancements



- Dodd-Frank strengthens the SEC's enforcement powers in several key respects:
 - Aiding and abetting – lower standard (“reckless”) for an SEC enforcement proceeding
 - Authorizes SEC to bring “control person” cases
 - Broader penalties in administrative proceedings
 - Clarifies international jurisdiction
 - Increases SEC funding and autonomy in budget requests
 - Even prior to Dodd-Frank, SEC has restructured its staff and greatly increased enforcement activity in light of banking crisis and Madoff scandal – loaded for bear
 - Be careful out there!

Rulemaking Projects

- Disclosure of CEO/Chairman structure
- Hedging disclosure
- Pay versus performance disclosure
- Pay equity disclosure



Rulemaking Projects (cont'd)

- Exchange Listed Companies



- Restrictions on broker discretionary voting
- Tighter independence standards for compensation committees
- More powers for compensation committees to hire outside advisers
- Clawback policy

Proxy Access

- Act authorizes SEC to grant to large shareholders the right to nominate directors **and** have nominees included in management proxy statement
- On August 25, 2010, the SEC adopted Rule 14a-11, the proxy access rule originally proposed in June 2009
- Some good news! 3 year delay for smaller reporting companies
 - Will apply to 2014 proxy season
 - SEC wanted to give smaller companies a chance to see what practices develop; may do further rulemaking for smaller companies before rules become effective



Proxy Access

- The rule applies to all public companies subject to the proxy rules (not foreign private issuers) and registered investment companies
- Access granted to S/Hs (or groups) who have continuously for 3 years owned at least 3% of the company's outstanding stock (and continue to hold the stock through annual meeting)
- Must include S/H nominees in the proxy statement for up to 25% of the total board seats (rounded down)
 - If nominees are received above limit, access granted to the largest S/H or group

Proxy Access

- What it means
 - The rule may shift the balance of power toward activist shareholders – shareholders can run a “short slate” without paying the cost of solicitation
 - Shareholders may form groups to gain proxy access
 - The rule is likely to be challenged in court
- How to prepare
 - Consider amendments to advance notice bylaws to conform to the new rules
 - Consider actively engaging with shareholders who might be capable of nominating directors
 - Focus on practices that might be problematic, including compensation practices

Questions?



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