
Corporate Governance, Clawbacks, and Whistleblowers Requirements

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Corporate Governance, Compensation and Clawbacks

Proxy Access

- SEC is granted authority to adopt rules providing shareholders with access to company proxy to nominate directors.
- SEC has promulgated essentially the same rules that they had proposed before the enactment of Dodd-Frank.
- Business groups have brought suit to block the implementation of these rules on procedural grounds.
- Supporters of broad shareholder access assert that such rules will improve board accountability. Critics claim that these rules will provide shareholder activists with particular agendas the ability to press those agendas.

Corporate Governance

- Chairman and CEO Structure – SEC must adopt rules requiring periodic disclosure on why issuers have decided to combine, or not to combine, the roles of chairman and CEO.
- Small Cap issuer Exemption to Sarbanes-Oxley Act §404(b) – Issuers that are not “large accelerated filers” or “accelerated filers” are exempt from having to provide independent auditor’s attestation report on management’s assessment of the effectiveness of internal control over financial reporting.
- Broker Voting – Brokers are prohibited from voting in a shareholder vote with respect to election of directors, executive compensation, or any other “significant matter” (as determined by the SEC), unless they receive specific voting instructions.

Say on Pay

- Starting with the first shareholders' meeting held more than six months after the enactment (the 2011 meeting for calendar year companies), public companies must provide for a separate, non-binding shareholder vote to approve the compensation of certain executive officers ("Say-on-Pay").
- At the same meeting, each public company must seek shareholder direction as to whether to have such a Say-on-Pay vote annually, biennially or triennially, and must repeat this vote at least once every six years.

Say on Pay

- Proposed Rule 14a-21(b) and new Item 24 of Schedule 14A would require issuers, not less frequently than once every six years, to provide a separate shareholder advisory vote to determine whether the shareholders will provide a Say on Pay every 1, 2, or 3 years.
- The SEC clarifies that it believes shareholders must be given four choices - 1, 2, 3 years or abstain - and proposes amendments to Rule 14a-4 to accommodate this. In addition, the release notes that the SEC would expect the Board to include a recommendation as to how often shareholders should vote.
- Like the Say on Pay vote, the shareholder vote on how often to have a Say on Pay vote is advisory. Companies may therefore choose not to follow the expressed shareholder preference.

Golden Parachutes

- At any shareholder meeting occurring more than six months after enactment to approve an acquisition, merger, or other extraordinary transaction, any compensation payments triggered by such a transaction (“Golden Parachute Payments”) must be disclosed in the proxy materials related to the meeting, and put to a separate, non-binding shareholder vote, to the extent that the arrangements have not been subject to a prior Say-on-Pay vote.

Golden Parachutes

- New Item 402(t) of Regulation S-K would require disclosure with respect to golden parachute compensation in proxy or consent solicitations in connection with an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all assets.
- This new Item requires, among other things, a specified tabular format for such disclosure.

Clawback Policy

- Listed companies must establish policies providing for recovery (or “clawback”) from current or former executive officers of “erroneously awarded” incentive compensation in the event of an accounting restatement required due to material noncompliance with financial reporting requirements under the securities laws.
- “Erroneous compensation” consists of the incentive compensation paid to an executive officer of the issuer during the 3 years preceding the restatement in excess of what would have been paid to the executive under the accounting restatement.

Whistleblower Provisions

Overview of Whistleblower Provisions

- SEC shall pay awards to eligible whistleblowers who voluntarily provide the SEC with “original information” that leads to a successful enforcement action yielding monetary sanctions of over \$1 million
 - The award amount will be between 10 percent and 30 percent of the total monetary sanctions collected
 - Determination of the amount awarded shall be “in the discretion of” the SEC
 - “Original information” means information “derived from independent knowledge or analysis of a whistleblower”; not known to the SEC; not exclusively derived from allegations made elsewhere, unless whistleblower is the source
 - Information must be essential to or significantly contribute to success of the investigation
 - Whistleblower anonymity/confidentiality

Overview of Whistleblower Provisions

- Prohibits retaliation by employers against whistleblowers and provides employees with a private cause of action in the event that they are discharged or discriminated against
- Authorizes the SEC to share whistleblower-provided information with enumerated federal, state and foreign enforcement authorities

Whistleblower Requirements

- Statutory denial of award to certain persons:
 - 1) regulatory personnel;
 - 2) someone **convicted** of a violation related to action reported; and
 - 3) auditors
- In addition, whistleblowers must follow the SEC's whistleblower procedures and rules
 - Will be released in April 2011
 - Proposed procedures for comment released on November 3, 2010

Key Issues and Concerns

- SEC's proposed rules anticipate some concerns:
 - Exclusion for people who have legal/contractual duties to report their information
 - “Front running”: exclusion for people who learn about violations through company's internal compliance program or through positions of responsibility, ***unless*** company does not disclose information to SEC within a reasonable amount of time or acts in bad faith
 - SEC would not pay “culpable” whistleblowers, e.g., where liability is based substantially on conduct the whistleblower directed

Key Issues and Concerns

- The Act creates financial incentives to report directly to the SEC. Significant implications:
 - Race to report issues before employees do
 - Highly-publicized investigations will likely cause floods of employee reporting
 - A new focus of the plaintiffs' bar (*qui tam* precedent)
 - Potential false alarms and spurious rumors
 - SEC rules attempt to mitigate:
 - Information submitted under penalty of perjury
 - Anonymous whistleblowers must have counsel and counsel must verify identity

Key Issues and Concerns

- Relationship to company compliance procedures
 - SEC's proposed rules treat employees as whistleblowers as of the date that they report information internally as long as they report the same information to the SEC within 90 days
 - SEC can consider awarding higher percentage awards to whistleblowers who first report information internally

Key Issues and Concerns

- Important for companies to reexamine internal procedures:
 - What mechanisms for complaints are available?
 - Are these mechanisms perceived as effective?
 - What steps are taken to ensure confidentiality and protection from retaliation?
- Encourage internal communication and create incentives for providing feedback or concerns
- Ensure that compliance programs are strong in the event of investigation

Key Issues and Concerns

- New whistleblower regime could impact internal investigations and self-reporting
 - Need for prompt internal response
 - Increased incentive to report conduct early
 - More circumspection needed
 - Implications for discussing the results of investigations with employees
 - Care required in conducting interviews of employees and potential whistleblowers
 - Document the reasons carefully for disciplinary actions taken against employees

Key Issues and Concerns

- Use of attorney-client privileged information
- Retaliation provision allows whistleblowers to claim retaliation on the basis of acts taken during internal investigation
 - Whistleblowers may claim protected status on the basis of statements that they made to counsel during the course of an internal investigation
 - Company's privilege; whistleblowers may seek work product and privileged information from internal investigation

Differences from SOX

- SOX whistleblower provisions had limited impact
 - Of the 1,273 SOX retaliation claims brought before the Department of Labor, employees received only 17 favorable decisions
- Act closes a key loophole for retaliation claims
 - SOX claims were frequently dismissed because claimant's employer was not a public company but rather an affiliate or subsidiary
 - The Dodd-Frank Act allows retaliation claims against employees of companies "whose financial information is included in the consolidated financial statements of [a publicly] traded company"

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Mr. Cagney authored “Compensation Committees”, *BNA Corporate Practice Series* (1998) and “Sirkin & Cagney, Executive Compensation”, *New York Law Journal Press* (1996). He is a frequent speaker and the author of numerous articles on executive compensation and issues pertaining to the investment under ERISA of plan assets by qualified employee benefit plans.

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