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SEC Delays Guidance on Key Executive Compensation Requirements under Dodd-Frank

Although the Securities and Exchange Commission ("SEC") has provided proposed rules for some provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), the SEC's timetable for adopting rules on key executive compensation requirements (in sections 953-955 of the Dodd-Frank Act) was delayed on July 29, 2011 ([see http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml#01-06-12](http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml#01-06-12)). The new adoption dates for these rules were pushed back to the January-June 2012 period. Below, we briefly summarize these requirements and the potential legislation that could eliminate one of the Dodd-Frank Act requirements entirely.

Delayed Rules on Executive Compensation Requirements – Although the shareholder "say on pay" requirement under the Dodd-Frank Act was applicable for the 2011 proxy season, it appears that the final rules for the four remaining key requirements described below will not likely be applicable for publicly traded companies until after the 2012 proxy season. The SEC apparently intends to issue proposed rules in these areas before the end of 2011.

- **Pay for Performance Disclosure.** Companies will be required to provide information in the annual proxy disclosures showing the relationship between executive compensation actually paid and the financial performance of the company and its stock.
- **Clawback Policy Requirements and Disclosure.** Companies will be required to develop and implement "clawback" policies (and to disclose such policies) with respect to incentive-based compensation (including stock options) in the case of accounting restatements due to material noncompliance with financial reporting requirements under the securities laws during the 3-year period prior to the date the restatement is required. These policies will apply to all current and former executive officers (not just the named executive officers) and will require the return of amounts in excess of what would have been paid under the accounting restatement.
- **Hedging Policy Disclosure.** Companies will be required to disclose information regarding whether employees or members of the board of directors are permitted to purchase financial instruments (e.g., collars or equity swaps) designed to hedge or offset declines in market value of equity securities granted to or held by the employees or directors.
- **Pay Ratio Disclosure.** Companies will be required to disclose the following: (a) the median annual total compensation of all employees except the CEO, (b) the annual total compensation of the CEO, and (c) the pay ratio of the CEO's compensation to the median compensation of all other employees. Under the statute, these compensation amounts must all be calculated using the SEC's complex proxy rules for determining an employee's total annual compensation.

The "Pay Ratio Disclosure" requirement will likely involve an enormous undertaking by each company. In particular, the use of the SEC proxy rules to determine each employee's total annual compensation will be extremely difficult because, in most cases, this calculation is currently performed for each company's named executive officers on a manual case-by-case basis. This manual process is due to the various sources of information required and the different standards used to calculate non-cash compensation under the complex SEC proxy rules. In addition, there are several ambiguities with respect to this pay-ratio disclosure requirement, including how and whether to take into account the compensation of overseas employees and how and when to determine the median compensated employee. Accordingly, this requirement has received significant criticism and may ultimately be repealed, as described below.

Proposed Legislation to Repeal Pay Ratio Disclosure – On June 22, 2011, the House Financial Services Committee voted to approve legislation (H.R. 1062, the "Burdensome Data Collection Relief Act") that would repeal the pay ratio disclosure requirement. Four Committee Democrats joined all Committee Republicans who were present in voting to approve the bill. Although Financial Services Committee Ranking Member Rep. Barney Frank (D-MA) voted against H.R. 1062, he offered an alternative amendment during the mark-up that would have generally provided that the pay ratio disclosure requirement applies only with respect to domestic employees and cash compensation. The amendment failed on a party-line vote. It is not yet clear when or if the full House of Representatives might consider H.R. 1062.

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