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MEMORANDUM

Date:	September 7, 2011
To:	Interested Persons
Re:	Compensation Clawback under Dodd Frank: Impact on Foreign Issuers

In the coming months, foreign private issuers (FPI) with a U.S. listing will have occasion to consider a new U.S. corporate governance requirement, introduced by the Dodd-Frank Act. Most of the corporate governance provisions of Dodd-Frank will not affect foreign private issuers, even those that have securities listed on a U.S. securities exchange. Section 954 of Dodd-Frank, however, will prohibit the listing of securities of issuers that have not developed and implemented incentive compensation claw-back policies. This provision will apply to foreign private issuers with U.S.-listed securities, even if the primary listing is an exchange outside the United States.

Requirements of Section 954

The SEC's web page outlining its plans for Dodd-Frank implementation indicates that the SEC will propose rules to implement Section 954 during the period from August to December 2011. Foreign private issuers should carefully review the proposed rules and consider commenting on them. Among other considerations, FPIs should evaluate whether the requirements under the proposal are inconsistent with local law or stock exchange requirements, or potentially give rise to issues that the SEC may not have considered in formulating the proposal.

The provisions of Section 954 of Dodd-Frank are relatively brief. Section 954 opens by saying that the SEC "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." In other words, the clawback policy will become mandatory for all issuers whose securities are listed on a U.S. national securities exchange, including the New York Stock Exchange and Nasdaq.

Under Section 954, the rules to be adopted by the SEC will require each issuer to develop and implement a policy providing for disclosure of the policy of the issuer on incentive-based compensation that is based on financial information required to be reported under the securities laws. Furthermore, the rules will require that:

> 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) during the 3-year period preceding the date on which the issuer is required to prepare an accounting restatement, based on the erroneous data, in excess of what would have been paid to the executive officer under the accounting restatement.

Background of Section 954

The Sarbanes-Oxley Act included a provision that may be viewed as a predecessor to the Section 954 requirement. Under Section 304 of Sarbanes-Oxley, the SEC can bring legal proceedings to require a chief executive officer or chief financial officer to reimburse an issuer for:

- any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following publication of financial statements, if they are subsequently restated, and

- any profits realized from the sale of securities of the issuer during that 12-month period.

The provision is only applicable if the restatement is due to material noncompliance, as a result of misconduct, with financial reporting requirements.

It is not entirely clear whether Section 304 applies only when the CEO or CFO personally engaged in the misconduct leading to the misstatement. In the case SEC v. Jenkins, decided by the Arizona federal court last year, the court agreed with the SEC's position that clawback may occur from a CEO or CFO who is not personally culpable.

A number of U.S. companies, going further than the requirements of Section 304, have adopted their own incentive compensation clawback policies. These companies have done so in part in response to pressure from activist shareholders. The policies vary in their application from company to company.

Dodd-Frank 954 Compared to SOX 304

In a number of respects, the requirements of Dodd-Frank Section 954 are stricter than those of Sarbanes-Oxley Section 304. In particular:

- Section 954 requires clawbacks without regard to whether misconduct has occurred;

- The look-back period is three years, rather than twelve months;

- Section 954 applies to current and former executive officers, not just the CEO and CFO, and

- Section 954 is enforced by the issuer, not the SEC.

Issues

The implementation of Section 954 will present the SEC with a number of significant issues, many of which have been forecast by public comments submitted to the SEC in anticipation of rulemaking. Some of these issues are described below.

Under Section 954, the clawback policy will apply to “executive officers.” However, the term is not defined there. Rule 3b-7 under the Securities Exchange Act of 1934 (“Exchange Act”) defines the term "executive officer" to means the president, any vice president of the registrant in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy making function or any other person who performs similar policy making functions for the registrant. Executive officers of subsidiaries may be deemed executive officers of the registrant if they perform such policy making functions for the registrant. The SEC will need to determine whether to use the Rule 3b-7 definition or some other definition.

The clawback policy will apply to "incentive-based compensation (including stock options awarded as compensation)". SEC regulations already define incentive-based compensation in the context of proxy statement disclosure requirements for U.S. issuers. The wording of Section 954 strongly suggests that the clawback policy need only apply to incentive-based compensation that is based on financial information required to be reported under the securities laws.

Calculation of the amount of the clawback will not always be straightforward. Clawback will be required for the "excess of what would have been paid to the executive officer under the accounting restatement". The determination of this amount may be unclear, for example in the case of an equity-based award, since the value of the equity will vary depending upon the time at which the value is measured. While the SEC might adopt bright-line rules for these sorts of issues, another approach would be to leave the relevant determinations to the board of directors or a committee of the board.

Tax considerations may also raise complicated issues. An executive required to return compensation may already have paid taxes on the compensation. Depending upon the laws of the relevant jurisdiction, the executive may or may not be able to recover all of the taxes previously paid, and if she is able to recover them the recovery may occur at a time that is significantly later than the time at which clawback is required.

There is some ambiguity as to when the three year recovery period contemplated by Section 954 begins and ends. Under Section 954, the period is the three years preceding “the date on which the issuer is required to prepare an accounting restatement …” In the case of a U.S. issuer, a Form 8-K filing may be required to report a restatement. If so, that may be the relevant date for purposes of this requirement. For a foreign registrant, however, Form 8-K is inapplicable. If the foreign registrant otherwise publishes a material restatement of its financial results, it will be required promptly to submit a Form 6-K with the publication. The SEC should evaluate whether the date of such publication, or the date of the Form 6-K submission, or some other date is the relevant date for purposes of this requirement.

Section 954 by its terms appears to contemplate that clawbacks will be enforced by the issuers themselves -- in contract to Sarbanes Oxley Section 304, which is enforceable only by the SEC. However, the statute does not specify whether an issuer is required in all cases of restatement, or whether issuers may themselves determine following a restatement whether to require clawbacks. If the SEC decides on the latter alternative, it might specify substantive or procedural criteria for the decision. In an analogous context -- the guidelines for clawbacks applicable to recipients of federal funds under the TARP program -- issuers are not required to enforce a clawback if to do so would be unreasonable. Among other imaginable circumstances, enforcement may be unreasonable if the costs of enforcement exceed the recoverable funds, or if the executive no longer has sufficient financial resources to return the funds. Enforcement

against former employees may be more difficult, as the issuer may be unable to withhold compensation otherwise payable.

Some who have commented on Section 954 to the SEC in anticipation of rulemaking have suggested that the rule include a de minimis threshold below which clawback is not required.

State laws governing creditors' ability to attach employee wages may limit an issuer's ability to enforce its clawback policy. Federal laws (such as Dodd-Frank) may of course preempt state law, but Section 954 relies for enforcement on policies adopted by issuers, not on a law or regulation. It is possible that courts will find that clawback policies adopted under the Section 954 requirement do not themselves have the status of federal law that can preempt state wage protection laws.

A company faced with practical or legal obstacles to recovering incentive payments from executives under a clawback policy might address those obstacles by using a deferred incentive compensation arrangement, in which funds are not disbursed to the executive until the period in which a restatement could trigger clawback has expired. The SEC in rulemaking might decide to require such arrangements, although it is unclear they have the authority to do so.

Section 954 raises retroactivity issues. To what extent will the rules require that clawback policies apply to compensation periods that precede the adoption of the policies by the issuers? Will they have to apply to executive officers who departed before the policies were adopted (or even before Dodd-Frank itself was enacted)? Will the policies supersede agreements (such as exculpatory agreements) with executive officers, even if those agreements were entered into prior to the adoption of the policies? A number of commenters have suggested that the clawback policies only apply to incentive compensation awarded after the effective date of rules under Section 954.

Application to Foreign Private Issuers

For a number of reasons, Section 954 will be less relevant to foreign private issuers than it is to U.S. issuers. First, as noted above, Section 954 only applies to a foreign private issuer whose securities are listed on a U.S. national securities exchange or national securities association. An issuer that registers its securities with the SEC -- for example, in connection with a merger registered on Form F-4 -- is not covered by the provision unless its securities are listed on a U.S. exchange.

Second, the SEC may decide to adopt a full or partial exemption for foreign private issuers. Section 954 does not itself authorize the SEC to grant an exemption. However, Section 954 operates by amending the Exchange Act to incorporate the clawback policy requirement. That Act, in turn, contains a general authorization for the SEC to exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision of the Act or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

Third, restatements are less common for foreign private issuers than they are for U.S. issuers. One reason is that foreign accounting principles, such as International Financial Reporting Standards, often provide for adjustments of accounting errors in current periods where U.S. GAAP requires a restatement. Furthermore, the laws of some jurisdictions limit restatements.

Finally, Section 954 is applicable only so long as the foreign private issuer is listed in the United States. It is possible to imagine a foreign private issuer that faces a need to restate its financial statements delisting in the United States and rescinding its clawback policy. (Its ability to rescind a board policy as applied to prior conduct may be constrained, however, by local law or local stock exchange requirements.)

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If you have any questions or comments with respect to the matters discussed above, please contact us.

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