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Dodd-Frank still affects proxy season heading into 2013

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It's proxy season, and public companies about to hold annual meetings must take into account the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, specifically its rules for proxy materials.

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Those rules are very much in flux. Given the extensive number of them that the Securities and Exchange Commission must still adopt, Dodd-Frank is likely to impact public companies through at least the 2013 proxy season.

In 2011, most public companies were required to hold an initial shareholder advisory vote on executive compensation, or say-on-pay, and determine the frequency of future say-on-pay votes, or say-on-when.

One result of the proposals was a handful of lawsuits. They were brought against about 40 companies that "failed" say-on-pay votes despite the plain language of the law declaring the votes to be advisory.

In at least nine cases, shareholders sued the directors citing the failed say-on-pay vote as substantive evidence of a breach of fiduciary duty. To date, none of the plaintiffs has prevailed, although one company agreed in December to settle the matter after losing a motion to dismiss.

Thus, although say-on-pay is technically advisory, public companies should be aware of the implications and potential fallout arising from a failed shareholder vote. Proxy advisory firms such as Institutional Shareholder Services have developed methods to analyze the relationship of pay and performance and determine whether to recommend approval of a company's executive compensation arrangements.

To gain shareholder support for their executive compensation arrangements and avoid a failed say-on-pay vote, public companies should be in tune with shareholder concerns regarding compensation, link executive pay to both long- and short-term company performance, and make effective use of the compensation discussion and analysis portion of their proxy statement.

This year, public companies will also be required to disclose whether and how they considered last year's voting results in setting compensation for their executives.

PROXY ACCESS

While Dodd-Frank did not mandate proxy access rules, SEC authority to issue them was confirmed in the legislation.

Shortly after passage of Dodd-Frank, the SEC issued Exchange Act Rule 14a-11 to allow shareholders to solicit votes for director nominees in the company's annual proxy statement.

In September, the U.S. Court of Appeals of the Federal Circuit struck down the rule, and the SEC declined to appeal. As a result, public company shareholders who wish to solicit votes for director nominees are still required at their own expense to prepare and distribute their own proxy statements to shareholders.

At the same time the rule was issued, the SEC amended Rule 14a-8, which left the door open for shareholders to propose their own company-specific proxy access mechanisms. Before the amendment, companies could exclude shareholder proposals for proxy access. A number of public companies already have received shareholder proposals to provide for proxy access, many of which suggest a process similar to the court-vacated Rule 14a-11.

WHISTLE-BLOWING REWARDS

The SEC's new whistle-blower rules officially launched in August. Mandated by Dodd-Frank, the new rules provide that eligible whistle-blowers may receive an award for providing information to the SEC concerning certain fraudulent activity.

Eligible whistle-blowers will receive 10 percent to 30 percent of monetary sanctions that exceed $1 million. The exact percentage will be determined by the SEC based on a number of factors.

Between the Aug. 12 effective date of the rules and Dec. 31, the SEC received 337 tips. The commission has not yet paid any awards under the program.

Public companies should continue to carefully review their internal compliance programs and policies in light

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of the new rules. This should include raising awareness of the incentives for potential whistle-blowers to first report information internally, rather than reporting directly to the SEC.

ADDITIONAL RULES

Several additional rules are expected to be adopted this year in time for the 2013 proxy season.

One of the more controversial rules intended to address perceived social issues is disclosure related to gold and other so-called conflict minerals that, according to the Secretary of State, are financing armed rebels in Congo and adjoining countries.

Another is disclosure of the pay disparity ratio that compares the salaries of a company's chief executive officer and the median employee.

The new rules are a recent trend in Congress to force public companies to disclose information related to social issues. While well-intentioned, they are inconsistent with the fundamental purpose of federal securities laws: investor protection.

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