VIA E-MAIL: rule-comments@sec.gov

September 11, 2015

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Listing Standards for Recovery of Erroneously Awarded Compensation (Release No. 34-75342); File Number S7-12-15

Dear Mr. Fields:

Duane Morris LLP appreciates the opportunity to submit this comment letter with respect to the proposed rule (the "Proposed Rule") of the Securities and Exchange Commission (the "Commission") to implement Section 10D of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which was added by Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act").

As counsel to a variety of public companies, we are very concerned about potential unintended consequences and inequities that could arise as a result of certain aspects of the Proposed Rule. As discussed below, in response to several of the questions posed in the proposing release, we recommend refinements that we believe will facilitate the Commission's implementation of the rules in a manner that achieves the objectives of Section 10D of the Exchange Act, makes it easier for the Commission, self-regulatory organizations ("SROs") and listed companies to oversee compliance with the rules, reduces the likelihood that potential adverse consequences would occur and ameliorates the risk of inequities.

I. *The definition of "executive officer" should focus on a prescribed set of officers who have important roles in preparing financial statements or setting the tone-at-the-top for managing the issuer.*

The proposing release asks: "*Alternatively, is the proposed definition of 'executive officer' too broad? Should we instead limit the recovery policy to 'named executive officers,' as defined in Items 402(a)(3) and 402(m)(2) of Regulation S-K or otherwise define a more narrow set of officers subject to recovery?*" (Question 23)

The recovery policy should be limited to "named executive officers," as defined in Items 402(a)(3) and 402(m)(2) of Regulation S-K ("NEOs"), and the issuer's chief accounting officer, if such person is not a named executive officer as defined.

In the proposing release, the Commission states that "we believe that it is clearly appropriate for officers with an important role in financial reporting to be subject to the recovery policy." We note that the Proposed Rule, however, is much broader since it includes officers who may not have any role in preparing or vetting financial statements. The Commission also states in the proposing release that "we believe applying the recovery policy to all executive officers would more effectively realize the statutory goal of Section 10D because officers with policy making functions and important roles in the preparation of financial statements set the tone for and manage the issuer." The Proposed Rule, however, goes beyond that required by Congress in passing the Dodd-Frank Act. To avoid this problem, the Proposed Rule should, instead, focus on NEOs (which term, by definition, includes all individuals serving during the applicable period as the principal financial officer and the principal executive officer). These key individuals, along with the chief accounting officer and the three or more other NEOs who lead the company, are sufficient since the rule thereby would cover both the primary "officers with an important role in financial reporting" and those other officers uppermost in the organization who have the greatest ability to "set the tone for and manage the issuer".[1]

The proposing release further asks: "*Will the scope of the term 'executive officer' for purposes of Section 10D affect issuers' practices in identifying executive officers for other purposes? If so, how, and what if anything should we do to address that? Are there other means of simplifying the identification of "executive officers" for purposes of Rule 10D-1 that would promote consistency with identifying executive officers for other purposes, such as Item 401(b) of Regulation S-K? Is there another, more appropriate definition?*" (Question 24)

The Proposed Rule predictably will have the unintended consequence of impacting issuers' decisions in identifying their "executive officers" for purposes of Item 401(b) of Regulation S-K as well as their "officers" for purposes of Section 16 of the Exchange Act, in each case in a manner adverse to investors. Another reason to use the specific definition prescribed in Items 402(a)(3) and 402(m)(2) of Regulation S-K, along with the issuer's chief accounting officer (if such person is not an NEO as defined), is that this approach eliminates an issuer's discretion in defining covered officers and prevents such unintended consequences that would extend beyond this context and adversely affect other objectives of the disclosure rules. Moreover, because the determination of an issuer's NEOs and chief accounting officer is clearly prescribed by existing rules that are already well known to reporting companies, refining the

[1] Compliance and oversight will be much easier for the Commission, SROs and listed companies by not creating differing, but overlapping, definitions to describe individuals subject to this new provision.

definition in this manner would simplify the oversight roles of the Commission, the SROs and the regulated community.

This approach will also promote consistency among issuers in the identification and scope of the executive officers subject to the claw back rule and for whom such rule requires disclosure. Moreover, by incorporating the NEO definitions, recovery and disclosure will generally be required with respect to officers already the focus of an issuer's compensation disclosures.

Issuers should be permitted to adopt claw back policies that provide the maximum deterrent effect on officers who should have participated in preventing material errors that result in a restatement – as distinguished from treating all executive officers alike, irrespective of their ability to influence financial reporting or the actions of officers with an important role in financial reporting.

II. *Controlled companies should be exempted from the proposed listing standards and other requirements of the Proposed Rule and rule amendments.*

The proposing release asks: "*Should the listing standards and other requirements of the proposed rule and rule amendments apply generally to all listed issuers, as proposed? If not, what types of issuers should be exempted, and why? Please explain the rationale that justifies exempting any particular category of issuer.*" (Question 1)

No, the Proposed Rule should not apply generally to all listed issuers. The listing standards and other requirements of the Proposed Rule and rule amendments should be harmonized so that they are consistent with Section 10C of the Dodd-Frank Act, in which Congress *excluded* controlled companies and foreign private issuers from the listing standards for compensation committees.[2] *See also* SEC Release Nos. 33-9330; 34-67220, "Listing Standards for Compensation Committees," 77 Fed. Reg. 38422, 38436-38 (June 27, 2012) (observing that Section 10C of the Exchange Act contains four provisions relating to exemptions from its requirements and noting that Section 10C(g) specifically exempts controlled companies as therein defined from all of Section 10C's requirements, and further observing that, under Section 10C(a)(1), the Commission also is exempting foreign private issuers that provide annual disclosures to shareholders of the reasons why the issuer does not have an independent compensation committee).

[2] In pertinent part, Dodd-Frank Act Section 10C (Compensation Committees) provides:.

(a) INDEPENDENCE OF COMPENSATION COMMITTEES.—

(1) LISTING STANDARDS.—The Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any equity security of an issuer, other than an issuer that is a controlled company, limited partnership, company in bankruptcy proceedings, openended management investment company that is registered under the Investment Company Act of 1940, or a foreign private issuer that provides annual disclosures to shareholders of the reasons that the foreign private issuer does not have an independent compensation committee, that does not comply with the requirements of this subsection.

Apart from the need to be consistent with the expressed Congressional intent to treat controlled companies and foreign private issuers differently for purposes of the listing standards, the controlling shareholder of a controlled company[3] does not need the Proposed Rule's protections. Controlling shareholders are in a position to make an informed cost-benefit analysis and, in addition, take into consideration other factors, both objective and subjective, in determining whether or not to impose claw back rights or other remedial provisions. In this respect the interests of controlling shareholders are aligned with the issuer's other shareholders.[4] Instead of enhancing a controlled company's ability to tailor a recovery policy to most effectively protect the interests of its shareholders, the Proposed Rule would, if applicable to a controlled company, limit this ability in a manner not required Section 10D. A shareholder whose investment is sufficient to control a listed company is necessarily sophisticated and well informed about financial reporting and compensation issues, closely monitors the issuer it controls and by definition is in a position to protect the interests of the controlled company's shareholders.

III. ***The rule should focus on the protection of investors, and accordingly claw back policies should not require issuers to recover incentive-based compensation if the cost of recovery would reasonably be expected to exceed the benefits, or to recover de minimis amounts.***

The proposing release asks: "*Should the standard for exercising discretion not to recover be limited to the extent to which that recovery is impracticable? Should direct costs of recovery be a basis for exercising discretion not to recover? If so, what specific costs of recovery should be considered? For example, should only direct expenditures to third-parties be considered, as proposed? Should we further define what constitutes 'direct costs'? Should an issuer be permitted to consider indirect costs, such as opportunity costs or reputational costs? Should the issuer disclose the cost estimates in its Exchange Act annual reports? If the cost estimates are*

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[3] Under Section 10C(g)(2) of the Exchange Act, a ''controlled company'' is defined as an issuer that is listed on an exchange and that holds an election for the board of directors of the issuer in which more than 50% of the voting power is held by an individual, a group or another issuer. See also Rules 405 and 12b-2 which define the term control by reference to the power to direct the management and policies of a company:

> Control. The term *control* (including the terms *controlling*, *controlled by* and *under common control with*) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

17 C.F.R. §§ 230.405, 240.12b-2.

[4] Assuming, *arguendo*, that a controlling shareholder acts contrary to the rights of the minority, state laws protect minority shareholders' rights. Under Delaware law, for example, "a shareholder is 'controlling' if . . . [it] controls a majority of the votes in a corporation or . . . controls less than a majority but there is evidence that . . . [it] exercises control over the board." Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder,* 89 TEX. L. REV. 1293, 1315 n. 97 (2011) (internal citations omitted). In addition, by being a controlling shareholder, it is "deemed to owe fiduciary duties to the remaining 'minority' or 'noncontrolling' shareholders" and "special rules apply to the legal standard for alleged breaches of fiduciary duties" which may include stripping away the protection of the business judgment rule in instances involving self-dealing. *Id.* at 1315 (internal notes omitted).

not disclosed in the issuer's annual reports, should those costs be independently verified?" (Question 52)

Requiring an issuer to expend greater resources than it would recover under the rule would be inconsistent with the objective of protecting investors and removes the necessary flexibility and discretion that state laws have traditionally and properly conferred on Boards as part of their fiduciary oversight responsibilities.[5] Therefore, Boards should have discretion, if not the mandate, to determine not to pursue recovery whenever the costs of recovery – whether direct or indirect – exceed the benefits to investors. In making these determinations, Boards should consider comprehensively the cost of financial, compensation, legal and accounting advisors whose services would be required to make the necessary assessments called for by the Proposed Rule, as well as the costs of collection, the diversion of company resources and other such costs that are not purely direct, out-of-pocket expenses. The rule should provide a safe harbor for a Board's determination that seeking recovery is not in the best interests of its shareholders because it is not economically rational to the issuer. The rule should not uniformly require issuers to incur the expense of costly event studies or similar evaluations that would reasonably be expected to exceed the economic benefit of recovery under the rule in order to permit the Board to avail itself of the safe harbor.

The proposing release further asks: "*Should the issuer first be required to make a reasonable attempt to recover that compensation, as proposed? If so, should we specify what steps to recover excess incentive-based compensation should be required or what constitutes a 'reasonable attempt' to recover such compensation? Should this requirement depend on what financial reporting metric triggers recovery? Should the issuer be required to document its attempts to recover, and provide that documentation to the exchange?*" (Question 53)

A reasonable attempt to recover should be made if and to the extent that the Board determines, in view of the economic costs and benefits to the issuer, that it is in the best interests

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[5] As Professor Stephen M. Bainbridge observed after Sarbanes-Oxley's reform measures were enacted, "The Supreme Court . . . has consistently recognized that state law governs the rights and duties of corporate directors. * * * [R]egulators must pay due respect to the principles of federalism that have governed corporation law since the New Deal. As a general rule of thumb, federal law appropriately is concerned mainly with disclosure obligations, as well as procedural and antifraud rules designed to make disclosure more effective. In contrast, regulating the substance of corporate governance standards is appropriately left to the states." Stephen M. Bainbridge, *The Creeping Federalization of Corporate Law,* 26 REGULATION 27, 31 (2003), *available at* https://www.sec.gov/comments/4-537/smbainbridge1431.pdf.

SEC Commissioner Daniel Gallagher echoed Bainbridge's concerns about what he called the "Federalization of Corporate Governance" while addressing Dodd-Frank's reform measures at the 26th Annual Corporate Law Institute at Tulane University Law School on March 27, 2014: "Some of [SOX and Dodd-Frank's] requirements unashamedly interfere in corporate governance matters traditionally and appropriately left to the states. Others masquerade as disclosure, but are in reality attempts to affect substantive behavior through disclosure regulation. This mandated intrusion into corporate governance will impose substantial compliance costs on companies, along with a one-size-fits-all approach that will likely result in a one-size-fits-none model instead. This stands in stark contrast with the flexibility traditionally achieved through private ordering under more open-ended state legal regimes." http://www.sec.gov/News/Speech/Detail/Speech/1370541315952#.Uzr4pRb31US of the issuer's shareholders to seek recovery. The rule should not, however, require an attempt to recover that would reasonably be expected to result in an issuer's incurrence of costs greater than the benefits of recovery. Requiring a Board to act in a manner that it has determined is not in the best interests of its shareholders both would be contrary to state corporate law and would defeat the statutory goal of Section 10D to protect investors.

In addition, in view of the realities of the costs of professional advisors and the attention of management, the rule should specify a *de minimis* amount, such as $50,000 with respect to any one executive officer, that would not trigger any obligation to incur costs to evaluate or recover such immaterial amounts.

IV. ***The listing standards should not require claw back policies that impose inequitable outcomes on an issuer's executive officers, such as subjecting individuals to recovery for periods when they were not serving in the requisite capacity, or requiring them to disgorge more incentive-based compensation than the officer received after payment of taxes.***

The proposing release asks: "*Is it consistent with the purposes of Section 10D to apply recovery to any incentive-based compensation earned during the three completed fiscal years immediately preceding the date that the issuer is required to prepare a restatement if that person served as an executive officer at any time during the performance period? Alternatively, should an individual be subject to recovery only for incentive-based compensation earned during the portion of the performance period during which the individual was serving as an executive officer? Should an individual who is an executive officer at the time recovery is required be subject to recovery even if that individual did not serve as an executive officer of the issuer at any time during the performance period for the affected incentive-based compensation? If a different standard should govern the circumstances when an executive officer or former executive officer is subject to recovery, what should that standard be, and why should it apply?*" (Question 25)

An individual should be subject to recovery only for incentive-based compensation earned during the portion of the performance period during which the individual was serving as an NEO or the chief accounting officer of the issuer. This approach is consistent with the rationale set forth in the proposing release in which the Commission indicates, for example, that "officers with policy making functions and important roles in the preparation of financial statements set the tone for and manage the issuer." While Congress did not require an executive officer to be at fault for the material error requiring a restatement under Exchange Act Section 10D as a condition to recovering incentive compensation from that officer, Congress did not require (or presumably intend to mandate) recovery from an officer during a period in which the officer was *not* in the requisite position to affect either the financial reporting or the tone-at-the-top and management of the issuer. The Proposed Rule exceeds Congress's expressed intent because it would require the recovery of all incentive-based compensation earned during the *entire* three completed fiscal years immediately preceding the date that the issuer is required to prepare a restatement – from any executive officer who served as such at *any time* during the performance period. This is an unnecessary and inequitable result that exceeds what Congress required in passing the Dodd-Frank Act.

For example, under the Proposed Rule, if an individual becomes an executive officer on December 31, 2018, and a restatement is required with a look-back covering the period from January 1, 2016 through December 31, 2018, that individual would be forced to disgorge compensation for a period during which he or she had no ability to affect policy-making functions, the preparation of financial statements, or the tone-at-the-top or management of the issuer. Similarly, if the individual was an executive officer for only the last year of that period, recovery should be limited to the incentive-based compensation earned during the period when he or she was in a position to affect the issuer's policy-making, preparation of financial statements, tone-at-the-top and management, unless the officer was responsible for a material error that impacted a greater portion of the recovery period.

By enacting Section 10D of the Exchange Act, Congress did not mandate the enactment of claw back policies that impose *strict liability* on such a wide range of corporate officers as the Commission proposes.[6] Applying the claw back rule as broadly as the Commission proposes exceeds Congress's expressed intent and would penalize *innocent* corporate officers who cannot influence the making of financial reports.[7] An irrebuttable presumption[8] that someone who has a position of responsibility in a listed company also can prevent erroneous financial reports is erroneous, is contrary to settled common law principles and is likely unconstitutional.[9]

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[6] In order to avoid upsetting the Constitution's checks-and-balances of power, the Commission should not exceed Congress's expressed intent when promulgating the implementing rules to this provision of the Dodd-Frank Act. *See generally* Stephen M. Bainbridge, *The Creeping Federalization of Corporate Law*, 26 REGULATION (SPRING 2003) ("The Constitutional drafters devised a system of shared power between the federal and state governments, by crafting a series of checks and balances that included the three branches of federal government – the bicameral Legislative Branch (U.S. Const. Art. 1), the Executive Branch (U.S. Const. Art. 2), and the Judicial Branch (U.S. Const. Art. 3).").

[7] By comparison, Section 20(a) of the Exchange Act, while providing for joint and several liability for control persons, doesn't impose liability for those who act in good faith.

[8] On due process grounds, the use of irrebuttable presumptions has been found unconstitutional. *See, e.g., Francis v. Franklin*, 471 U.S. 307, 314 n.2 (1985) ("A mandatory presumption may be either conclusive or rebuttable."); *Vlandis v. Kline*, 412 U.S. 441, 452 (1973) (observing that the 14th Amendment's due process clause forbids an irrebuttable presumption "when that presumption is not necessarily or universally true in fact, and when the State has reasonable alternative means of making the crucial determination."). In a seminal decision, the Court only upheld the constitutionality of the "Park Doctrine" (also called the "Responsible Corporate Officer Doctrine") by reading an "impossibility" or "powerlessness" defense into the provisions of the Food Drug & Cosmetics Act at issue. *United States v. Park*, 421 U.S. 658, 673 (1975) ("The [FDCA] … does not require that which is objectively impossible. The theory upon which responsible corporate agents are . . . liable for 'causing' violations of the Act permits a claim that the defendant was 'powerless' to prevent or correct the violation to 'be raised defensively at a trial on the merits.'").

[9] *See, e.g.,* Martin Petrin, *The Curious Case of Directors' and Officers' Liability for Supervision and Management-Exploring the Intersection of Corporate and Tort Law*, 59 AM. U.L. REV. 1661, 1667 (2010) ("[A]t common law, directors and officers are not personally liable for the torts of a corporation or of any other agent merely because of their position. Instead, some additional connection is required. Courts have developed various approaches to test whether a director or officer has a sufficient enough connection . . . to hold him personally liable. For the most part, the different theories or approaches overlap . . . and courts can apply combinations or variations of the theories. Nevertheless, the theories can be roughly divided into three approaches: first, and most common,

The proposing release further asks: "*Do the proposed rule and rule amendments articulate an appropriate standard for calculating the amount of excess incentive-based compensation that listed issuers must recover? Why or why not?*" (Question 43)

It would be punitive and inequitable to require an executive officer to disgorge incentive-based compensation on a pre-tax basis after taxes have been paid on that amount.[10] This concern underscores the need for flexibility in making these types of recovery calculations on a case-by-case basis and the need for an issuer's Board to have reasonable discretion in determining how to recover compensation that must be repaid – whether in cash, in kind, from future compensation payments, or otherwise. Many executive officers may face serious hardship if required to rapidly liquidate assets sufficient to disgorge three years of incentive-based compensation, which could further exacerbate the potential inequity to such individuals. For example, there are many potential legal restrictions on an executive officer's ability to liquidate equity securities of an employer – such as (i) if the executive is then in possession of material nonpublic information; (ii) if the executive is then in a blackout period for trading; (iii) if the executive is then in a six-month Section 16B short-swing profits period prohibiting a sale; (iv) if the issuer has stock ownership requirements that would prohibit the executive from selling; and (v) if potential Rule 144 limitations apply. Moreover, if the current price of the shares is depressed in connection with the announcement of the restatement, requiring an executive without sufficient liquidity to rapidly fund a recovery by disposing of such equity compensation would result in further inequities. These are factors that the issuer's Board should be permitted to consider and address in the manner that it determines to be in the best interests of the shareholders – for example, by recovering equity awards subject to claw backs either in cash or in kind over reasonable periods of time – and the Board should have reasonable discretion in implementing these recoveries.[11]

If the claw back rule limits the discretion of an issuer's Board in a manner that does not permit an issuer reasonable flexibility to implement the recoveries required by Congress under Exchange Act Section 10D, it could have the unintended consequence of incentivizing Boards to find other ways to preserve their statutory role, such as adopting performance standards that provide lower hurdles, leaving maximum discretion with the compensation committee in order to preserve the Board's discretion that such a rule would seek to displace, or adopting performance standards that relate to goals that would not be implicated by restatements. This would be counterproductive and could lead to inconsistencies with the goal of investor protection and other policy objectives.[12]

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where the court focuses on the defendant's participation in a tort; second, where the court focuses on whether a personal duty was breached; and third, where the court pierces the corporate veil.") (internal citations omitted).

[10] The proposing release does not appear to reflect adequate coordination between the Commission and the Internal Revenue Service regarding the tax effects of the Proposed Rule.

[11] For example, in some cases a Board may elect to structure a recovery to serve a retention function as well, thereby enhancing the benefit to the issuer of the economic recovery.

[12] For example, this result would appear to be inconsistent with tax policy underlying Rule 162(m) and the interests of shareholders who prefer that compensation should be tied more directly to performance.

V. *Foreign private issuers should not be required to violate home country law in order to comply with the new listing standards mandated by the Proposed Rule, but rather the rule should permit greater deference to local law and international comity.*

The proposing release asks: "*Should a listed issuer be permitted to forego recovering incentive-based compensation if doing so would violate home country law? In this circumstance, should the issuer first be required to obtain a legal opinion from home country counsel, as proposed? If not, why not? Are there any other conditions that should be met beyond a legal opinion from home country counsel before an issuer should be permitted to forego recovering incentive-based compensation in these circumstances? Should the proposed accommodation apply only to the extent that recovery would conflict with home country laws in effect before the date of publication of proposed Rule 10D-1 in the Federal Register, as proposed? If not, please explain why not. In addition, as proposed, the listed issuer would need to provide such opinion to the exchange upon request. Should a copy of this opinion be filed with the Commission as an exhibit? Why or why not?*" (Question 54)

The listing standards should not force foreign private issuers to choose between violating home country law or the listing standards required by the Proposed Rule, irrespective of when the home country law becomes effective. The policy as proposed would be inconsistent with both the protection of investors and the Commission's obligation to give due consideration to the rule's impact on the promotion of efficiency, competition and capital formation, as well as the policy objectives underlying the rules encouraging foreign private issuers to subject themselves to Commission oversight. Moreover, as previously observed, the listing standards and other requirements of the proposed rule and rule amendments should be harmonized to be consistent with Section 10C of the Dodd-Frank Act, in which Congress *excluded* foreign private issuers from the listing standards for compensation committees.[13] *See also* SEC Release Nos. 33-9330; 34-67220, "Listing Standards for Compensation Committees," 77 Fed. Reg. 38422, 38436-38 (June 27, 2012) (observing that Section 10C of the Exchange Act contains four provisions relating to exemptions from its requirements and noting that under Section 10C(a)(1) the Commission is exempting foreign private issuers that provide annual disclosures to shareholders of the reasons why the issuer does not have an independent compensation committee).

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[13] In pertinent part, Dodd-Frank Act Section 10C (Compensation Committees) provides:.

(a) INDEPENDENCE OF COMPENSATION COMMITTEES.—

(1) LISTING STANDARDS.—The Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any equity security of an issuer, other than an issuer that is a controlled company, limited partnership, company in bankruptcy proceedings, openended management investment company that is registered under the Investment Company Act of 1940, or a foreign private issuer that provides annual disclosures to shareholders of the reasons that the foreign private issuer does not have an independent compensation committee, that does not comply with the requirements of this subsection.

We appreciate the opportunity to participate in the comment process regarding the Commission's Proposed Rule. We would be pleased to discuss our comments with you or answer any questions you may have concerning them. You may direct any correspondence concerning this letter to Darrick M. Mix at [redacted] or Shelton M. Vaughan or Michael E. Clark at [redacted].

Very truly yours,

Duane Morris LLP