MERIDIAN
COMPENSATION PARTNERS, LLC

September 14, 2015

Via E-Mail (rule-comments@sec.gov)

Mr. Brent J. Fields, Secretary
Securities and Exchange Commission
100 F. Street, N.E.
Washington, D.C. 20549-1090

Re: File No. S7-12-15—Proposed Rule to Implement the Mandatory Clawback Provisions of Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

Dear Mr. Fields:

Meridian Compensation Partners, LLC ("Meridian") is pleased to provide comments to the Securities and Exchange Commission ("Commission") on the Commission's proposed rule to implement the mandatory clawback provisions of Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act").

Meridian is one of the largest independent executive compensation consulting firms in North America. We provide trusted counsel to Boards and Management at hundreds of large public and private companies, consulting on executive compensation design issues, corporate governance matters and related disclosures. Our consultants have decades of experience in developing pay solutions that are responsive to shareholders, reflect good governance practices and align with company performance.

Section 954 of the Dodd-Frank Act, which added Section 10D to the Securities Exchange Act of 1934 ("Exchange Act"), mandates the Commission to direct the national securities exchanges and national securities associations ("Securities Exchanges") to establish listing standards that would require each listed company to develop and implement a mandatory clawback policy compliant with Section 954 and SEC rules and to disclose the clawback policy.

On July 1, 2015, the Commission issued proposed Rule 10D-1 under the Securities Exchange Act of 1934 (Listing Standards for Recovery of Erroneously Awarded Compensation, Release Nos. 33-9861 and 34-75342 (June 1, 2015) [80 FR 41143] (referred to herein as the "Release")). Set forth below are our comments on proposed Rule 10D-1 ("Proposed Rule").

Summary of Recommended Changes to the Proposed Rule

The following is a summary of Meridian's recommended changes to the Proposed Rule, which is followed by a detailed rationale for each of these recommendations.

- Revise the definition of "**financial reporting measure**," for purposes of the determining incentive-based compensation subject to mandatory clawback, to **exclude** financial reporting measures related to company stock price and total shareholder return on company stock.
- Preclude the retroactive application of the Proposed Rule to incentive-based compensation that is granted ***before*** its effective date and paid due to the attainment of a financial reporting measure based on or derived from financial information for any fiscal period ending on or after its effective date.

Recommended Changes to the Proposed Rule

We are recommending that the Commission revise the Proposed Rule in the following manner for the reasons indicated:

- **Revise the definition of "financial reporting measure" to exclude measures relating to share price and total shareholder return**. For the reasons discussed below, we recommend that the Commission revise the definition of "financial reporting measure" to exclude measures related to company stock price and total shareholder return (TSR) on company stock.

  Under the Proposed Rule, incentive-based compensation subject to a company's mandatory clawback policy would include compensation granted, earned or vested based wholly, or in part, upon the attainment of **any "financial reporting measure."** Financial reporting measures would include measures related to company stock price and TSR on company stock. For example, a share award that vests upon the attainment of a specified level of TSR on company stock at the end of a performance period would be subject to a company's mandatory clawback policy under the Proposed Rule. In the event of an accounting restatement, a company would need to determine the effect of the accounting restatement on share price at the conclusion of such performance period. Based on this recalculated share price, a company would be required to determine if and to what extent the share award would have been earned. The number of shares that were paid in excess of this recalculated earned amount would be subject to clawback.

  The inclusion of company stock price and TSR on company stock in the definition of financial reporting measures is inconsistent with the express terms of Section 954 of the Dodd-Frank Act and is impractical in its application. Unlike the Proposed Rule, Section 954 of the Dodd-Frank Act does not explicitly define incentive-based compensation that must be subject to a company's Dodd-Frank compliant mandatory clawback policy. However, Section 954 does set forth the determination of "excess" incentive-based compensation. Under Section 954, excess incentive-based compensation subject to mandatory clawback is the amount by which incentive-based compensation previously paid to any current or former executive officer is "in excess of what would have been paid to the executive officer under the accounting restatement." Implicit in this determination of excess incentive-based compensation is that the reach of Section 954 is limited to incentive-based compensation that is linked to the achievement of specific financial metrics (accounting measures).

  In the Release, the Commission asserts that its broader interpretation of Section 954 is justified, in part, on the language of Section 10D(b)(1) of the Exchange Act, which requires disclosure of an issuer's policy with respect to "incentive-based compensation that is based on financial information required to be reported under the securities laws." The Commission acknowledges that the statutory phrase "financial information required to be reported under the securities laws" might be interpreted as applying "only to accounting-based metrics…."[1] Nonetheless, the Commission claims such phrase also "includes performance measures such as stock price and total shareholder return that are affected by accounting-related information and that are subject to our disclosure requirements."[2] To support this conclusion, the Commission cites to Item 201 of Regulation S-K, which requires issuers to disclose certain stock price information.

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[1] Release at p. 43.
[2] Id.

The Commission's interpretation fails to take into account the interaction between Sections 10D(b)(1) and 10D(b)(2). Paragraph (b)(1) sets forth disclosure requirements while paragraph (b)(2) sets forth the substantive clawback rules. Although paragraph (b)(1) provides that a clawback policy should cover incentive-based compensation that is based on "***financial information,"*** paragraph (b)(2) provides for recovery based on erroneous ***accounting*** data, which is a more specific term. The Commission's interpretation rests on the theory that the general language of paragraph (b)(1) should control (or influence) the interpretation of the specific language set forth in paragraph (b)(2). However, statutory construction principles generally require that a statute's specific language should override (or be used to interpret) its general language. As discussed above, the specific language of paragraph (b)(2) clearly demonstrates that Section 954 is limited in scope to incentive-based compensation linked to the achievement of financial **accounting** measures.

The Commission makes the following additional argument in support of its broad interpretation of Section 954:

> Congress' direction to include compensation that is based on financial information and to recover compensation based on the erroneous accounting data suggests that we should include incentive compensation tied to measures such as stock price and total shareholder return to the extent that improper accounting affects such measures, and in turn results in excess compensation.[3]

The foregoing argument assumes that "financial information" may be properly interpreted to cover company share price and TSR of company stock. As discussed above, we do not believe that is a reasonable interpretation of the Section of the Exchange Act. Further, nothing in the legislative history of the Dodd-Frank Act supports the Commission's conclusions that the Section 954 mandates "suggest" that the Commission include in the definition of financial reporting measures stock price and TSR of company stock.

The reasonableness of the Commission's proposed definition of financial reporting measure to include share price and TSR on share price is further undermined by the requirement that amounts subject to clawback would be based wholly on a speculative determination of the effect of an accounting restatement on share price. In the Release, the SEC acknowledged the uncertainty related to such determinations.

> In some cases, issuers may need to engage in complex analyses that require significant technical expertise and specialized knowledge, and may involve substantial exercise of judgment in order to determine the stock price impact of a material restatement. Due to the presence of confounding factors, it sometimes may be difficult to establish the relationship between an accounting error and the stock price.[4]

To mitigate the above issues, the Proposed Rule would permit a company to "estimate" the effect of an accounting restatement on its share price. However, no universally recognized method or methods exist for making such an estimation. Regardless of the estimation or valuation method used by a company to determine the effect of an accounting restatement on share price, the outcome will be the same: amounts subject to clawback will ***not*** be based on a factual determination but on a speculative determination. A plain reading of Section 954 indicates that Congress did not contemplate recovery of

[3] Release at p. 43-44.
[4] Release at p. 44.

compensation from an executive officer based on such a speculative determination. We believe that if Congress intended for such recoveries, it would have clearly articulated this in Section 954.

- **Preclude the retroactive application of the Proposed Rule**. For the reasons discussed below, we recommend that the Proposed Rule should be revised to preclude its application to incentive-based compensation granted under a pre-existing agreement or plan ***before*** the final rule's effective date and paid due to the attainment of a financial reporting measure based on or derived from financial information for any fiscal period ending on or after its effective date.

  The Proposed Rule would apply to incentive-based compensation when both of the following conditions are present:

  — The incentive-based compensation was paid due to the attainment of a financial reporting measure based on or derived from financial information for any fiscal period ending on or after the effective date and

  — The incentive-based compensation was granted, ***earned or vested*** on or after the effective date.

  This application of the Proposed Rule could result in the clawback of excess incentive-based compensation that relates to a multiyear award granted prior to the effective date but that is earned and vested after the effective date. For example, if the effective date is December 1, 2016, the Proposed Rule would apply to a performance share award granted on January 1, 2014 that is earned based on the achievement of a three-year financial metric through December 31, 2016 (i.e., compounded average revenue growth rate).

  This potential retroactive application of the Proposed Rule to outstanding compensatory awards could result in the recoupment of compensation in violation of the terms of such awards. The Commission dismisses this potential issue by asserting that companies could amend existing awards (or related contracts) "to accommodate recovery,"[5] presumably without the consent of the award holder. However, in many, if not most, cases, such an amendment would require the consent of the award holder[6]. Obtaining such consent could prove problematic particularly from former executive officers who hold outstanding equity awards. Thus, companies could face two equally unappealing choices: (1) amend outstanding awards without award holders' consent and face potential litigation from award holders claiming such amendment is in violation of the award agreement or (2) not apply the mandatory clawback policy on a retroactive basis and face potential litigation from shareholders and action by the Commission.

  To avoid the foregoing outcomes, we recommend that the Commission revise the Proposed Rule to apply on a prospective basis (i.e., solely to awards granted on or after the effective date of the final rule).

We believe that our recommended revisions to the Proposed Rule would simplify its application and mitigate the risk of unintended consequences.

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[5] Release at p. 69.

[6] It is a common practice for equity awards to include so-called "anti-cutback provisions" that require an award holder's written consent to any amendment thereto that could result in a diminution to the participant's benefits under the award. Arguably, an amendment subjecting an award to the Dodd-Frank mandated clawback policy could result in such a diminution of a participant's benefits.

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We appreciate the opportunity the Commission has afforded the public to comment on its Proposed Rule implementing Section 954 of the Dodd-Frank Act. We welcome the opportunity to discuss with the Commission and its staff our comments provided herein.

Sincerely,

Meridian Compensation Partners, LLC

Donald G. Kalfen
Partner