PUBLIC COMPANY PERSPECTIVES
APRIL 2011

Welcome to the inaugural issue of Herrick, Feinstein's *Public Company Perspectives*. We are presenting this newsletter to keep our friends and colleagues informed of the latest developments in matters pertaining to public companies and the laws that govern them. We plan to issue *Public Company Perspectives* quarterly or more frequently to address timely issues that would be of interest to readers. As we launch this new publication, we welcome your feedback, and hope you will find *Public Company Perspectives* to be a valuable resource.

Proposed Rules:

Proposed Rules Requiring Listing Standards for Compensation Committees

On March 30, 2011, the Securities and Exchange Commission proposed rules directing the national securities exchanges to adopt listing standards related to the compensation committee of a company as well as its compensation advisers. These rules are mandated by Section 10C of the Securities Exchange Act of 1934, which was added as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Section 10C requires the SEC to direct national securities exchanges to adopt listing standards relating to:

- the independence of the members on a compensation committee;
- the committee's authority to retain compensation advisers; and
- the committee's responsibility for the appointment, compensation and oversight of the work of any compensation adviser.

Section 10C also requires each company to modify its proxy statement disclosure regarding compensation consultants to include whether its compensation committee retained or obtained the advice of a compensation consultant, whether the work of the compensation consultant has raised any conflict of interest, and the nature of any such conflict and how it is being addressed.

The SEC's proposal, which tracks closely Section 10C, would require the exchanges to adopt listing standards that:

- Require each member of a company's compensation committee to be subject to independence requirements developed by the exchanges, considering:

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Dates to Remember:

April 22, 2011
Good Friday – SEC Open; U.S. markets closed.

May 2, 2011
Deadline to file a proxy statement for companies that incorporate into Part III of their Form 10-K information from their proxy statement, or to file an amendment to their Form 10-K to include the Part III information.

May 10, 2011
Deadline for Large Accelerated Filers and Accelerated Filers to file Form 10-Q for quarter ended March 31, 2011.

May 16, 2011
Deadline for Non-Accelerated Filers and Smaller Reporting Companies to file Form 10-Q for quarter ended March 31, 2011; Deadline to file Form 13-F for quarter ended March 31, 2011.

May 30, 2011
Memorial Day - SEC and U.S. markets closed.

June 15, 2011
Domestic and foreign reporting companies that are not Large Accelerated Filers and that use US GAAP and foreign reporting companies that use IFRS will be required to attach an XBRL exhibit to their first quarterly or annual report, as applicable, that contains financial statements for a period ending on or after this date.

June 30, 2011
Deadline for Foreign Private Issuers to file Form 20-F (fiscal year ending December 31).

- the sources of compensation of a director, including any consulting, advisory or compensatory fee paid by the company to such director; and

- whether a director of a company is affiliated with the company, a subsidiary of the company, or an affiliate of a subsidiary of the company.

- Provide that the compensation committee (a) may, in its sole discretion, retain or obtain the advice of a compensation adviser, (b) be directly responsible for the appointment, compensation and oversight of the work of any compensation advisers, and (c) be appropriately funded by the company.

- Provide that a compensation committee may select a compensation consultant, legal counsel or other adviser only after considering the following independence factors:

  - Whether the compensation consulting company employing the compensation adviser is providing any other services to the company;

  - How much has the compensation consulting company received in fees from the company, as a percentage of the compensation consulting company's total revenue;

  - What policies and procedures have been adopted by the compensation consulting company to prevent conflicts of interest;

  - Whether the compensation adviser has any business or personal relationship with a member of the compensation committee;

  - Whether the compensation adviser owns any stock of the company; and

  - Any other additional considerations imposed by the exchanges.

As directed by Section 10C, the proposed rules would require the exchanges to exempt the companies meeting any of the following categories from the compensation committee independence requirements:

- Controlled companies, meaning those companies that are listed on an exchange and in which 50% or more of the voting power is held by a single investor or group of investors;

- Limited partnerships;

- Companies in bankruptcy proceedings;

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Quote of the Day I:

"Enforcement of the securities laws is the foundation of the SEC's mission. Swift and vigorous proceedings directed at those who have broken the law are at the heart of the agency's efforts to protect investors."

– Mary Schapiro, Chairman, SEC, in testimony before the Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. House of Representatives, March 15, 2011.

Quote of the Day II:

"Knowing those things now, I wish that [David Becker, former General Counsel of the SEC] had recused himself."

– Mary Schapiro, Chairman, SEC, in testimony to a House Oversight subcommittee on March 10, 2011, regarding Mr. Becker's involvement on a SEC proposal involving the compensation of Madoff victims even though he had inherited money from his deceased mother's account with Mr. Madoff.

- Open-end management investment companies registered under the Investment Company Act of 1940; and

- Any foreign private issuer that discloses in its annual report the reasons why the foreign private issuer does not have an independent compensation committee.

The proposed rules also:

- authorize the exchanges to exempt a particular relationship from the independence requirements applicable to compensation committee members, and to exempt certain categories of issuers, as the national securities exchange or national securities association deems appropriate, from all of the requirements of the new compensation committee listing standards; and

- eliminate the current disclosure exception for services that are limited to consulting on broad-based plans or providing non-customized benchmark data, but would retain the fee disclosure requirements, including the exemptions from those requirements.

This proposed release is not the final step relating to this matter. Once the SEC reviews the comments it receives and publishes its final rule in the Federal Register, the exchanges would then have 90 days to provide the SEC with proposed rules or rule amendments and one year to have final rules or rule amendments approved by the SEC.

Proposed Amendments to Rule 17Ad-17; Transfer Agents', Brokers', and Dealers' Obligation to Search for Lost Securityholders; Paying Agents' Obligations to Search for Missing Securityholders.

On March 18, 2011, the SEC proposed to revise Rule 17Ad-17 of the Securities Exchange Act of 1934 relating to transfer agents' obligations to search for lost securityholders, to:

- extend to brokers and dealers the requirement to search for lost securityholders;

- add a requirement that "paying agents" notify "missing securityholders" in writing that the paying agent has sent the missing securityholder a check that has not yet been negotiated;

- add an exclusion for paying agents from the notification requirements when the value of the not-yet-negotiated check is less than $25; and

- add a provision clarifying that the written notification requirements shall have no effect on state escheatment laws.

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The SEC adopted Rule 17Ad-17 in 1997 to address situations where transfer agents lose contact with securityholders by requiring the transfer agents to conduct database searches for lost securityholders, as the loss of contact can be harmful to securityholders because they no longer receive corporate communications or the interest and dividend payments to which they may be entitled. Additionally, their securities and any related interest and dividend payments are often placed at risk of being deemed abandoned under operation of state escheatment laws.

The proposed amendments are designed to implement the directive of the Dodd-Frank Act to extend the application of Rule 17Ad-17 to brokers and dealers. Brokers are generally defined as any person engaged in the business of effecting transactions and securities for the accounts of others. A dealer is defined as any person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise. According to the proposal, the SEC believes as a practical matter that primarily large clearing firms will have obligations under the amended rule because such firms carry securities for the accounts of its customers, as opposed to introducing firms, which do not.

Pursuant to the proposal, there would be a requirement that a paying agent must provide written notification no later than seven months after the sending of any not-yet-negotiated check to each missing securityholder to inform the missing securityholder that a not-yet-negotiated check has been sent. A paying agent would be defined to include any issuer, transfer agent, broker, dealer, investment adviser, indenture trustee, custodian or any other person "that accepts payments from an issuer of securities and distributes payments to securityholders." A person would be considered a missing securityholder if a check is sent to the securityholder, and the check is not negotiated before the earlier of the paying agent sending the regular scheduled check or the elapsing of six months after the sending of the not-yet-negotiated check. A paying agent, however, would be excluded from the notification requirements if the value of the not-yet-negotiated check is less than $25. The notification requirement imposed on paying agents would have no effect on state escheatment laws; therefore, it would not effect the time periods used in state escheatment laws to determine account dormancy.

The proposed amended rules would also require paying agents to maintain records, for a period of not less than three years with the first year in an easily accessible place, to demonstrate their compliance with the rule.

In order to provide paying agents with sufficient time to develop systems to comply with the proposed amendments, the SEC proposes to establish a compliance date for the amendments of one year following the date on which the SEC takes final action on the proposal.

Comments on this proposal are due no later than May 9, 2011.

Beneficial Ownership Reporting Requirements and Security-Based Swaps

On March 17, 2011, the SEC issued a proposed rule to clarify that after Section 13(o) of the Exchange Act becomes effective on July 16, 2011, persons who purchase or sell security-based swaps will remain within the scope of the beneficial ownership rules to the extent they are now.

Section 766 of the Dodd-Frank Act added Section 13(o) by providing that for purposes of Section 13 and Section 16 of the Exchange Act,

> "a person shall be deemed to acquire beneficial ownership of an equity security based on the purchase or sale of the security-based swap, only to the extent that the [SEC], by rule, determines after consultation with the prudential regulators and the Secretary of the Treasury, that the purchase or sale of the security-based swap, or a class of security-based swap, provides incidents of ownership comparable to direct ownership of the equity security, and that it is necessary to achieve the purposes of this section that the purchase or sale of the security-based swaps, or class of security-based swap, be deemed the acquisition of beneficial ownership of the equity security."

The purpose of the proposed rule is to preserve the existing scope of the SEC rules relating to beneficial ownership and to provide the certainty and protection that market participants have come to expect with the existing disclosures required under Sections 13(d), 13(g), and 16(a) after Section 13(o) becomes effective. The SEC determined that Section 766 of the Dodd-Frank Act may be interpreted to render existing beneficial ownership determinations inapplicable to a person who purchases or sells security-based swaps. Absent the clarification from the proposed rule, the SEC is concerned that, among other things, an investor may be able to use a security-based swap to accumulate an influential or control position in a public company without disclosure, or an insider may no longer be subject to Section 16 reporting requirements and short-swing profit recovery.

To preserve the regulatory status quo, the SEC proposes to readopt without change the relevant portions of Rule 13d-3 and 16a-1, which set forth the standards applied to determine whether a security-based swap confers "beneficial ownership" to the security holder. Rule 13d-3 requires a person or group who owns 5% or more of the equity securities of a public company to make a disclosure filing under Section 13(d). Rule 16a-1 requires owners of more than 10% of the equity securities of a public company to make a disclosure filing under Section 16 and provides that such beneficial owners are subject to disgorgement of short-swing profits and short-sale restrictions. Currently, a security-based swap confers beneficial ownership of the underlying securities to the swap holder if the swap is settled in securities or provides voting or investment power with respect to the underlying securities. However, security-based swaps that are settled exclusively in cash generally fall outside the definition of beneficial ownership because they do not entail voting or investment power.

The re-adoption of the rules are not intended or expected to change any existing administrative or judicial application or interpretation of the beneficial ownership rules, but are intended to ensure that persons who use security-based swaps remain subject to the current regulatory regimes relating to beneficial ownership to the same extent such persons are now. Moreover, the proposed rules are designed to preserve the private right of action provided by Section 16(b) and do not disturb any other existing right of action. While these proposals are only intended to preserve the existing applications of the beneficial ownership rules as they relate to security-based swaps, the SEC notes that it is engaged in separate projects to develop proposals to modernize reporting under Sections 13(d) and 13(g). Any such proposals will be covered in a later edition of Public Company Perspectives.

Comments on this proposal are due no later than April 15, 2011.

Disclosure of Incentive-Based Compensation Arrangements at Financial Institutions

On March 2, 2011, the SEC proposed a rule that would require SEC-regulated brokers, dealers and investment advisers with $1 billion or more in assets to disclose the structure of their incentive-based compensation practices so regulators can determine whether such compensation is excessive or could lead to material financial loss to the firm and would prohibit those institutions from maintaining any type of incentive-based compensation arrangements that regulators determine encourage inappropriate risks by providing excessive compensation or that could lead to material financial loss to the institution.

The proposed rule contains the following three elements:

- ***Disclosures About Incentive-Based Compensation Arrangements.*** A covered financial institution would be required to file annually with the appropriate federal regulators, a report describing the institution's incentive-based compensation arrangements, including a narrative description of their components, a succinct description of the institution's policies and procedures governing such arrangements and a statement of specific reasons as to why the institution believes the structure of such arrangements will help prevent it from suffering a material financial loss or does not provide covered persons with excessive compensation.

- ***Prohibition on Encouraging Inappropriate Risk.*** A covered financial institution would be prohibited from establishing or maintaining an incentive-based compensation arrangement that encourages inappropriate risks by providing covered persons – executive officers, employees, directors or principal shareholders –with excessive compensation or that can lead to material financial loss. The proposal states that incentive-based compensation arrangements would be deemed to encourage inappropriate risks unless the incentive-based compensation arrangement meets certain standards. In assessing these arrangements, regulators will consider, among other things, the combined value of all benefits provided to the covered person; compensation history of the covered person and other individuals with comparable expertise; the financial condition of the institution; for post-employment benefits, the projected total cost and benefit to the financial institution; and any connection between the individual and any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the covered financial institution.

The proposed rule lays out more specific requirements for executive officers and certain other designated individuals at financial institutions with $50 billion or more in total consolidated assets, requiring these firms to defer for three years, at least 50% of any incentive-based compensation for executive officers and award the compensation no faster than on a pro-rata basis. Any incentive-based compensation payments must be adjusted for losses incurred by the covered financial institution after the compensation was initially awarded. This proposed rule will also apply to other employees that may have the ability to impact the risk profile of the financial institution and that may expose the institution to risk of significant loss. Under the proposed rule, the board of directors or a committee of the board of directors would be charged with identifying the covered persons, other than executive officers, who individually have the ability to expose the firm to possible losses that are substantial in relation to the institution's size, capital or overall risk tolerance. This could include for example, a trader with large position limits relative to the institution's overall risk tolerance. Once the board indentifies such covered person, the board or the committee would need to approve the incentive-based compensation arrangement for each such person.

- ***Policies and Procedures.*** A covered financial institution would be barred from establishing an incentive-based compensation arrangement unless the arrangement has been adopted under policies and procedures developed and maintained by the institution and approved by its board. The proposed rule recognizes the diversity of the institutions covered by the rule and explicitly states that the policies and procedures should be commensurate with the size and complexity of the organization as well as the scope and nature of its use of its incentive-based compensation.

The SEC will be working with the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the Federal Housing Finance Agency and the National Credit Union Administration to jointly write the rules or guidelines. The proposed rules will be substantially similar from agency to agency, but are expected to contain technical differences to account for the different entities that the various agencies regulate. Although the SEC has approved the proposed rule release, each agency must individually review and approve the proposed rule for public comment before the proposal is published in the Federal Register. Once published in the Federal Register, the public will be given 45 days to comment.

SEC's Division of Corporation Finance Issues Nine New Compliance and Disclosure Interpretations

On March 4, 2011, the Division of Corporation Finance of the SEC issued nine new Compliance and Disclosure Interpretations, or CDIs. CDIs are interpretations that reflect the views of the staff of the Division, and are not rules, regulations or statements of the SEC, and are not binding on the SEC due to their highly informal nature. Nevertheless, they provide an invaluable resource to practitioners with respect to interpretive guidance on many areas of securities law. The new CDIs are as follows:

- An issuer who includes material non-public information in its offering memorandum when conducting an offering pursuant to Rule 144A and Regulation S does not satisfy Regulation FD by filing the entire offering memorandum as an exhibit to Form 8-K at the time of distribution of the offering memorandum to potential investors. The issuer could instead file a Form 8-K setting forth the specific material non-public information with the limited information about the offering pursuant to Rule 135c of the Securities Act of 1933.

- With respect to a company that sells mandatorily exchangeable notes in a private offering, pursuant to which the notes can be exchanged for shares of an affiliate of the issuer at the issuer's option or upon the occurrence of certain events, the holding period under Rule 144 upon the exchange of the notes will begin to run at the time the investor purchased the notes from the issuer, as the exchange was outside of the investor's control. If the exchange would have been at the option of the investor, the holding period would begin on the date of the exchange. If the investor had the option to exchange the notes, but nevertheless the exchange took place because of the issuer's decision or the occurrence of events outside of the investor's control, then the holding period would begin at the time the notes were originally acquired.

- Under Rule 144(h), "concurrently" means that the Form 144 required pursuant to that rule should be transmitted for filing on the same day as the placing of a sale order or execution of the sale.

- A primary shelf-eligible issuer that is not a "Well-Known Seasoned Issuer" may not file a resale registration statement for a dollar amount of common stock and make a general statement that the registration statement covers common stock previously sold by the company in unregistered transactions. The resale registration statement must identify the initial transaction.

- A free writing prospectus may not be dispensed with under Rule 433(f)(2)(i) if the substance thereof was previously furnished (and not filed) with the SEC. In order to dispense with a free writing prospectus under Rule 433(f)(2)(i), the substance of the free writing prospectus must have previously been filed with, rather than furnished to, the SEC.

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- A package of written materials consisting only of an issuer's SEC filings, provided to unaffiliated and uncompensated media participants for possible use in media publication, need not be filed as a free writing prospectus because the package only includes information previously filed with the SEC. The media publication need not be filed as a free writing prospectus, either.

- Director information omitted from a proxy statement because the term of office of the director in question will not continue after the meeting to which the proxy relates, must still be included in a Form 10-K that otherwise provides its Part III information by incorporation by reference from the proxy statement.

- Companies are required to include information about a director's business experience in their SEC filings even if the director is appointed by holders of a class of preferred stock. In this situation, the company may either provide the same information about this director as it would about directors nominated by the board or disclose that the director was appointed by preferred stockholders and provide the information about the director's business experience that such preferred stockholders provided to the company pursuant to Item 401(e) under Regulation S-K.

A company is not required in its Compensation Discussion and Analysis to discuss executive compensation, including performance target levels, to be paid in the current year or in future years. The CD&A covers only compensation "awarded to, earned by, or paid to the named executive officers." Although Instruction 2 to Item 402(b) provides that the CD&A should also cover actions regarding executive compensation that were taken after the company's last fiscal year end, such disclosure requirement is limited to those actions or steps that could "affect a fair understanding of the named executive officer's compensation for the last fiscal year."

Litigation:

Matrixx Initiatives, Inc., et al. v. Siracusano, et al. On March 22, 2011, the U.S. Supreme Court, in *Matrixx Initiatives, Inc., et al. v. Siracusano, et al.*, reaffirmed the test of materiality that it established in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), and rejected the argument that there should be a bright line test for materiality based on statistical significance in a securities fraud suit.

Matrixx is a pharmaceutical company that sold an over-the-counter cold remedy called Zicam. Although Matrixx received complaints that users of the cold remedy lost their sense of smell, it announced to the market, among other things, that Zicam was an effective and safe cold remedy and offered a unique benefit to its users. Plaintiffs alleged, among other things, that Matrixx violated Section 10(b) of the Exchange Act and SEC Rule 10b-5 because Matrixx made material misstatements and omissions by failing to disclose adverse event reports relating to Zicam.

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The district court granted Matrixx's motion to dismiss, holding that adverse information relating to the safety of the product is not material unless there is a statistically significant correlation between the product and the adverse effect.

The Ninth Circuit Court of Appeals reversed the district court's decision, rejecting the statistically significant test to determine materiality of undisclosed information as a bright line rule contrary to Basic, Inc. v. Levinson, which requires a fact specific analysis. Under the standard established in Basic, misleading statements and omissions are material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."

The Supreme Court, in affirming the Ninth Circuit's decision in a unanimous opinion, held that materiality cannot be reduced to a bright line rule and, in this case, the plaintiffs alleged facts plausibly suggesting that reasonable investors would have viewed these particular adverse event reports as material.

The lesson learned from *Matrixx* is that companies must continue to analyze the total mix of information available to them as viewed by a reasonable investor in determining whether or not to disclose certain information and should not rely on a bright line test to determine materiality.

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