ALSTON + BIRD LLP

Employee Benefits & Executive Compensation ADVISORY

October 5, 2012

NYSE and Nasdaq Issue Proposed Listing Standards to Implement Exchange Act Rule 10C-1 Relating to Independence of Compensation Committees and Their Advisers

As reported in our recent advisory, SEC Adopts Final Rules Implementing Dodd-Frank Provisions on Independence of Compensation Committees and Their Advisers, on June 20, 2012, the Securities and Exchange Commission (SEC) issued final Rule 10C-1 under the Securities Exchange Act of 1934 ("Exchange Act") implementing the provisions of Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[1]

Right on schedule, the New York Stock Exchange (NYSE) issued proposed rules to amend its Listed Company Manual to comply with the requirements of Exchange Act Rule 10C-1, and The NASDAQ Stock Market (Nasdaq) followed with proposed rules to amend its Listing Rules on September 26, 2012.

This advisory summarizes the proposed NYSE and Nasdaq rules related to compensation committees and their advisors. Both exchanges' proposed listing standards are subject to public comment and SEC approval and could change before going into effect.

[1] https://www.federalregister.gov/articles/2012/06/27/2012-15408/listing-standards-for-compensation-committees/

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Compensation Committee Director Independence

NYSE	Nasdaq
Existing NYSE rules require each listed company to have a separate compensation committee consisting solely of directors who satisfy the NYSE's general independence requirements. Under the proposed rules, in affirmatively determining the independence of any director who will serve on the compensation committee, the board must consider *all factors specifically relevant* to determining whether a director has a relationship to the issuer that is material to that director's ability to be independent from management in connection with the duties of a compensation committee member, including, but not limited to: (A) The source of compensation of such director, including any consulting, advisory or other compensatory fee paid by the listed company to such director. • The board should consider whether the director receives compensation from any person or entity that would impair his or her ability to make independent judgments about the issuer's executive compensation. (B) Whether such director is affiliated with the issuer, a subsidiary or an affiliate of a subsidiary. • The board should consider whether the affiliate relationship places the director under the direct or indirect control of the issuer or its senior management, or creates a direct relationship between the director and members of senior management, in each case of a nature that would impair the director's ability to make independent judgments about the issuer's executive compensation.	In a new turn of events, Nasdaq-listed companies would be required to have a compensation committee consisting of at least two independent directors. Companies would no longer be permitted to have a majority of independent directors determine executive compensation (but the proposed rules would maintain the existing exception allowing a listed company to have a non-independent director serve on the compensation committee under exceptional and limited circumstances).[2] In addition to the existing Nasdaq standards of director independence, the proposed heightened independence standards for compensation committee members would: (A) Prohibit compensation committee members from accepting directly or indirectly *any* consulting, advisory or other compensatory fee[3] from an issuer or any subsidiary, beginning with the member's term of service on the committee; and (B) Require boards to consider the director's affiliations (with respect to relationships that occur during his or her term of service on the committee) in determining eligibility to serve on the compensation committee. • For this purpose, the board must consider whether the director is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer to determine whether such affiliation would impair the director's judgment as a member of the compensation committee.

2 *See* Nasdaq Listing Rule 5605(d)(3).

3 Compensatory fees would not include (i) fees received as a member of the compensation committee, the board of directors or any other board committee; or (ii) the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the listed company (provided that such compensation is not contingent in any way on continued service).

NYSE	Nasdaq
Noncompliance with the compensation committee independence requirements due to reasons outside the director's reasonable control would need to be cured by the earlier of the next annual meeting or one year after the disqualifying event, provided that the committee continues to have a majority of independent directors. Note that this limitation on the opportunity to cure is unique to the NYSE's proposed listed rules and is not contemplated by Rule 10C-1.	Noncompliance due to one vacancy, or one director ceasing to be independent due to circumstances beyond his or her reasonable control, would need to be cured by the earlier of the next annual shareholders meeting or one year from the occurrence of the event that caused the noncompliance. However, if the annual shareholders meeting occurs no later than 180 days following the event that caused the noncompliance, the listed company will instead have 180 days from such event to regain compliance.

Observations:

The proposed NYSE rules do not, as many had speculated, apply to compensation committee members the more rigid independence standards that apply to audit committee members under Exchange Act Rule 10A-3(b)(1) (which is the approach adopted by the proposed Nasdaq rules for compensation committee members). Instead, boards of NYSE-listed companies are permitted to make a more holistic assessment of the independence of compensation committees. To guide the board in making such assessment, the proposed NYSE rules contain the following commentary:

> "It is not possible to anticipate, or explicitly to provide for, all circumstances that might signal potential conflicts of interest, or that might bear on the materiality of a director's relationship to a listed company (references to "listed company" would include any parent or subsidiary in a consolidated group with the listed company). Accordingly, it is best that boards making "independence" determinations broadly consider all relevant facts and circumstances. In particular, when assessing the materiality of a director's relationship with the listed company, the board should consider the issue not merely from the standpoint of the director, but also from that of persons or organizations with which the director has an affiliation. Material relationships can include commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships, among others. However, as the concern is independence from management, the Exchange does not view ownership of even a significant amount of stock, by itself, as a bar to an independence finding."

By not imposing bright-line or numerical standards for assessing compensation committee independence, the NYSE decidedly is *not* concluding that sources and amounts of compensation received by committee members or other such affiliations are not important. To the contrary, the responsibility for identifying and assessing pertinent factors that could impair a director's ability to make *independent* judgments about the issuer's executive compensation has effectively been shifted to the board and its nominating committee. There are no "safety nets" for this purpose.

Moreover, there are still numerical standards embedded in the standards for "non-employee director" status for purposes of Section 16 of the Exchange Act and for "outside director" status under Section 162(m) of the Internal Revenue Code. One would presume that if a director failed to meet one or both of these tests (particularly on a recurring basis), that would be a factor in the board's assessment of independence of a compensation committee member for NYSE purposes.

The independence of compensation committee members can be particularly significant in other contexts (i.e., beyond compliance with exchange listing standards and maximizing tax deductions under Code Section 162(m)). Since the advent of say-on-pay in the United States, we have seen a proliferation of shareholder derivative suits filed against individual directors (for breach of fiduciary duty in making compensation decisions), executive officers (for unjust enrichment) and compensation consultants (for aiding and abetting). So far, most of these derivative suits have been dismissed on procedural grounds (which depends on the directors being found to be disinterested and independent with respect to the compensation decisions under attack). The plaintiffs' bar is tireless in trying to break past this procedural barrier and will be looking for ways to discredit claims of director independence. Accordingly, boards should be very mindful of anything (including the acceptance of consulting or advisory fees in any amount) that, when viewed in hindsight, could be interpreted as impairing a director's ability to make independent judgments about the issuer's executive compensation.

Compensation Committee Advisers

<table>
<tr><th>NYSE</th><th>Nasdaq</th></tr>
<tr><td>As required by Exchange Act Rule 10C-1, the NYSE's proposed rules provide that the compensation committee of a listed company:
must have sole discretion to retain or obtain the advice of a compensation consultant, separate legal counsel and other advisers;
must be directly responsible for the appointment, compensation and oversight of the work of the compensation consultant, legal counsel or advisers so retained; and
must be provided appropriate funding, as determined by the compensation committee, from the company for the payment of reasonable compensation to any such advisers to the committee.
Such responsibilities and authority are, for the most part, already required elements of the compensation committee charter under NYSE's listing rules.[4] Nonetheless, to avoid confusion, NYSE proposes to adopt the Rule 10C-1 requirements verbatim and require that compensation committee charters provide that the committee has all of such powers.</td><td>As required by Exchange Act Rule 10C-1, Nasdaq's proposed rules provide that the compensation committee of a listed company must have the specific compensation committee responsibilities and authority necessary to comply with Rule 10C-1 relating to the:
authority to retain compensation consultants, independent legal counsel and other compensation advisers;
authority to fund such advisers; and
responsibility to consider independence factors before selecting such advisers.
Listed companies would be required to adopt a formal, written compensation committee charter that specifies, among other things, such compensation committee responsibilities and authority.</td></tr>
</table>

[4] *See* Section 303A.05(b) of the NYSE Listing Manual.

Compensation Adviser Independence

<table>
<tr><th>NYSE</th><th>Nasdaq</th></tr>
<tr><td>Before engaging an adviser (other than in-house legal counsel), the compensation committee must consider all factors relevant to that person's independence from management, including, without limitation, the following six factors enumerated in Rule 10C-1:

• whether the person (firm) employing the compensation adviser is providing any other services to the company;
• how much the person employing the compensation adviser has received in fees from the company, as a percentage of that person's total revenue;
• what policies and procedures have been adopted by the person employing the compensation adviser 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
• whether there are any business or personal relationships between the executive officers and the compensation adviser or person employing the adviser.</td><td>Nasdaq also proposes to require the compensation committee to consider the same six factors enumerated in Rule 10C-1 before selecting an adviser.</td></tr>
</table>

Observations:

Neither the NYSE nor Nasdaq elaborated on the six independence factors listed in Exchange Act Rule 10C-1, effectively leaving the committees to construe and interpret these factors as best they can. The NYSE (but not Nasdaq) widened the field of inquiry by requiring the committee to consider "all factors" relevant to the adviser's independence from management, without giving direction as to what those might be.

The Dodd-Frank Act does not require that a compensation adviser be independent, only that the compensation committee *consider* the enumerated independence factors before selecting a compensation adviser. The factors should be considered in their totality and no one factor should be viewed as a determinative factor of independence.

While independence of *compensation consultants* has been a matter of focus for several years, the notion of "independent" legal counsel for the compensation committee is more recent. Notably, the SEC emphasized in the release adopting Rule 10C-1 that it does not construe the Dodd-Frank Act as requiring a compensation committee to retain independent legal counsel or as precluding a compensation committee from retaining non-independent legal counsel or obtaining advice from in-house counsel or outside counsel retained by the company or management.

The adopting release and an instruction in Rule 10C-1 confirms that a compensation committee need not even consider the six independence factors before consulting with or obtaining advice from *in-house counsel* (but still must do so before obtaining advice from outside counsel, whether engaged by the compensation committee, management or the issuer).

The NYSE proposed rules on adviser independence (including the requirement to assess the independence of compensation consultants, legal counsel and other advisers) would go into effect on July 1, 2013. The corresponding proposed Nasdaq rules would go into effect immediately upon the SEC's approval of those listing standards.

As a practical matter, the assessment of independence of compensation consultants (as opposed to other types of advisers) should be well underway now, given the requirement to disclose in the 2013 proxy statement whether the work of the compensation consultant has raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed. The term "conflict of interest" is not defined. However, the proxy rules identify the six adviser-independence factors from Rule 10C-1(b)(4) (discussed above) as among the factors that should be considered in determining whether a conflict of interest exists.

General Exemptions

NYSE	Nasdaq
The following categories of issuers would be exempt from the entirety of the new requirements: • controlled companies, • limited partnerships and companies in bankruptcy, • closed-end and open-end funds registered under the 1940 Act, • passive business organizations in the form of trusts (such as royalty trusts), • derivatives and special purpose securities, • issuers whose only listed equity security is a preferred stock, and • foreign private issuers that follow home country practice and disclose any significant ways in which their corporate governance practices differ from those followed by domestic companies under NYSE listing standards. *In a departure from Rule 10C-1, the NYSE does not propose to require foreign private issuers to disclose the reasons that it does not have an independent compensation committee*. The proposed rules do not create a blanket exception for smaller reporting companies, but such companies would be exempt from the heightened independence requirements for compensation committee members.	The following categories of issuers would be exempt from the entirety of the new requirements: • asset-backed issuers and other passive issuers, • cooperatives, • limited partnerships, • management investment companies, • controlled companies, and • foreign private issuers, provided such issuer discloses in its annual reports filed with the SEC (or on its website, if it does not file annual reports) (i) each requirement that it does not follow, (ii) the home country practice followed by the issuer in lieu of such requirements and (iii) the reasons why it does not have such a committee. While smaller reporting companies would be required to have a compensation committee comprised of at least two independent directors and a formal written compensation committee charter or board resolution that specifies the committee's responsibilities and authorities, smaller reporting companies would not be required to comply with the compensation committee eligibility requirements relating to compensatory fees and affiliation, or the requirements relating to advisers.

Effective Date and Transition Periods

NYSE	Nasdaq
• Requirements related to adviser independence and compensation committee responsibilities (e.g., authority to retain compensation advisers, authority to fund such advisers and responsibility to consider certain independence factors before selecting such advisers) would go into effect July 1, 2013. • The compensation committee heightened independence requirements would need to be satisfied by the earlier of (i) the issuer's first annual meeting after January 15, 2014, or (ii) October 31, 2014. • Existing transition periods available to (i) companies listing in connection with IPOs or that did not have a class of common stock registered under the Exchange Act prior to the listing date; (ii) companies listing in connection with a spin-off or carve-out; (iii) companies listing upon emergence from bankruptcy; (iv) companies previously registered under Section 12(g) of the Exchange Act and companies previously registered under Section 12(b) of the Exchange Act, to the extent the national securities exchange on which they were listed did not have the same requirement; and (v) companies that cease to qualify as a controlled company or a foreign private issuer would apply to the proposed new compensation committee requirements. • Special transition periods would be available to companies that cease to be smaller reporting companies.	• Requirements related to adviser independence and compensation committee responsibilities (e.g., authority to retain compensation advisers; authority to fund such advisers; and responsibility to consider certain independence factors before selecting such advisers) would be effective immediately. • Requirements related to compensation committee heightened independence would need to be satisfied by the earlier of (i) the issuer's second annual meeting held after the date of approval by the SEC of the new listing standards or (ii) December 31, 2014. • Existing transition periods for (i) companies listing in connection with an IPO, (ii) companies emerging from bankruptcy and (iii) companies ceasing to be controlled companies would apply to the proposed new compensation committee composition requirements. • The transition period available for companies listing in connection with an IPO would also be available to smaller reporting companies that cease to qualify as such.

What to Do Now?

- The first order of business is to lay the groundwork for the 2013 proxy statement disclosure as to whether the work of a compensation consultant identified under Item 407(e)(3)(iii) has raised any conflict of interest and, if so, the nature of the conflict and how it is being addressed.
- Now that the proposed exchange listing standards are out, it is time to vet your compensation committee members against the two "heightened independence" factors. These are similar to the audit committee independence standards for Nasdaq companies but allow a more holistic review by NYSE companies.
- Now is the time to prepare your compensation committee to evaluate its current advisers under the six adviser-independence factors enumerated in Rule 10C-1 (and any other relevant factors if you are a

NYSE-listed company), bearing in mind that there is no requirement that the committee's advisers actually be independent under such standards or otherwise.

- Review your compensation committee charter to be sure it covers the specific provisions required by the proposed rules.
- Finally, be sure to add to your compensation committee's annual work plan the annual assessment of compensation consultant conflicts of interest and adviser independence.

***This advisory was written by* Laura Thatcher *and* Kerry Wenzel.**

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Securities Law ADVISORY

August 24, 2012

SEC Releases Final Conflict Minerals Rule

On August 22, 2012, after a vigorous public debate and a 3-to-2 vote, the U.S. Securities and Exchange Commission (SEC) adopted final rules related to "conflict minerals" that originate in the Democratic Republic of Congo (DRC) or the countries adjoining the DRC (collectively "Covered Countries").[1] Companies that file reports with the SEC, including domestic issuers, foreign private issuers and smaller reporting companies, are subject to the rules if conflict minerals are "necessary to the functionality or production" of a product manufactured by a reporting company. Companies that are subject to the conflict minerals rules must determine, following a "reasonable country of origin inquiry," whether their conflict minerals did in fact originate in a Covered Country. If they did, the company is required to submit a certified report to the SEC that includes a description of the measures the company has taken to exercise due diligence regarding the source and chain of custody of such minerals. The term "conflict minerals" includes columbite-tantalite, cassiterite, gold, wolframite, their derivatives or any other mineral or its derivatives determined by the Secretary of State to be financing conflict in the Covered Countries. Many of these minerals are commonly used in products such as cellphones, light bulbs and jewelry. The SEC has previously estimated that approximately 6,000 companies will be affected by this rule.

Adoption of a rule on conflict minerals was required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). A late addition to Dodd-Frank, Section 1502 added Section 13(p) to the Securities Exchange Act of 1934, as amended (the "Exchange Act") and reflected Congress' effort to mitigate the humanitarian crisis in Central Africa, based on the assumption that international trade in valuable minerals originating in the Covered Countries fuels violence in the region. The final rule is similar to the proposed rule in many respects, but does contain several important differences, which are noted below.

What Is Covered by the Conflict Minerals Rule?

The final rule, Rule 13p-1 of the Exchange Act, applies to any company subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act and for which conflict minerals are "necessary to the functionality or production" of a product manufactured or contracted to be manufactured by the company. If a company's products do not contain conflict minerals, then it has no disclosure obligations under the final rule.

Whether a company will be considered to be "contracting to manufacture" a product will depend upon the degree of influence a company exercises over the product's manufacturing. A company **will not** be deemed to have influence over a product's manufacturing if it:

- affixes its brand, marks, logo or label to a generic product manufactured by a third party;
- services, maintains or repairs a product manufactured by a third party; or

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[1] *See* 75 Fed. Reg. 80,948 (Dec. 23, 2010). "Adjoining countries" means countries that share a border with the DRC and include Angola, Burundi, the Central African Republic, the Republic of the Congo, Rwanda, Sudan, Tanzania, Uganda and Zambia.

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- specifies or negotiates contractual terms with a manufacturer that do not directly relate to the manufacturing of the product.

What Must Registrants Do?

If a reporting company uses conflict minerals, then it must conduct a "reasonable country of origin inquiry," to be performed in good faith and reasonably designed to determine whether any of its conflict minerals originate from Covered Countries or are from scrap or recycled sources (as opposed to mined sources). If the company:

- finds that its minerals did not originate in a DRC country or are from scrap or recycled sources; or
- has no reason to believe that the minerals may have originated in Covered Countries or may not be from scrap or recycled sources;

then the company must disclose this determination in its annual report, including a description of the inquiry it undertook and the results of the inquiry, using the new Form SD. The company must also make this information available on its website, and provide the Internet address of the website in the Form SD. Note that the Form SD will be considered "filed" and not furnished, and will thus be subject to Exchange Act Section 18 liability. The Form SD must be signed on behalf of a registrant by an executive officer.

On the other hand, if the company's inquiry indicates that both of the following are true:

- The company knows or has reason to believe that the minerals may have originated in the Covered Countries; and
- The company knows or has reason to believe that the minerals may not be from scrap or recycled sources;

then the company must perform due diligence on the source and chain of custody of the conflict minerals it uses and file a Conflict Minerals Report as an exhibit to the Form SD. The company must also make the Conflict Minerals Report available on its website, and provide the applicable Internet address in the Form SD. The due diligence that companies required to file a Conflict Minerals Report must perform must conform to a nationally or internationally recognized due diligence framework, such as that provided by the Organization for Economic Cooperation and Development (OECD).

If after due diligence a company determines that its products are "DRC conflict free," meaning the conflict minerals it utilizes may originate from Covered Countries but do not finance or benefit armed groups, then the company must have its Conflict Minerals Report audited by an independent private sector auditor, certify that it obtained the audit and include the audit report as part of the Conflict Minerals Report. The company must also identify the auditor.

If a company's products have not been found to be "DRC conflict free," then the company, in addition to the above audit and certification requirements, must describe in its Conflict Minerals Report the following:

- the products manufactured or contracted to be manufactured that have not been found to be "DRC conflict free";
- the facilities used to process the conflict minerals in those products;
- the country of origin of the conflict minerals in those products; and
- the efforts undertaken to determine the mine or location of origin, using the greatest possible specificity.

In a departure from the proposed rule, companies that cannot immediately determine the source of conflict minerals can describe the products using such minerals as "DRC conflict undeterminable" for up to two years (four years for smaller reporting companies). In this case, the company must describe in its Conflict Minerals Report the following:

- the products manufactured or contracted to be manufactured that have not been found to be "DRC conflict undeterminable";
- the facilities used to process the conflict minerals in those products, if known;
- the country of origin of the conflict minerals in those products, if known;
- the efforts undertaken to determine the mine or location of origin, using the greatest possible specificity; and
- the steps it has taken, or will take, if any, since the end of the period covered in its most recent Conflict Minerals Report to mitigate the risk that its conflict minerals benefit armed groups, including any steps to improve its due diligence.

For products that are "DRC conflict undeterminable," the company is not required to obtain an audit of the Conflict Minerals Report, at least as it relates to the conflict minerals in those products.

What Efforts Will Satisfy the Due Diligence Requirements?

The SEC created special rules governing the due diligence and Conflict Minerals Report for minerals from recycled or scrap sources. If a company can reasonably conclude that its conflict minerals are from recycled or scrap sources rather than mined sources, then it need not file a Conflict Minerals Report. If a company cannot reasonably conclude that any gold it utilizes is from recycled or scrap sources, then it is required to undertake due diligence in accordance with the OECD Due Diligence Guidance, and obtain an audit of its Conflict Minerals Report. The SEC singles out gold because it says gold is the only conflict mineral with a nationally or internationally recognized due diligence framework for determining whether it is recycled or scrap, which is part of the OECD Due Diligence Guidance. For the other three conflict minerals (columbite-tantalite, cassiterite and wolframite), if a company cannot reasonably conclude after its inquiry that its minerals are from recycled or scrap sources, until a widely recognized due diligence framework is developed, the company is required to describe in its Conflict Minerals Report the due diligence measures it exercised in determining that its conflict minerals are from recycled or scrap sources. In such cases a company is not required to obtain an independent private sector audit regarding these conflict minerals.

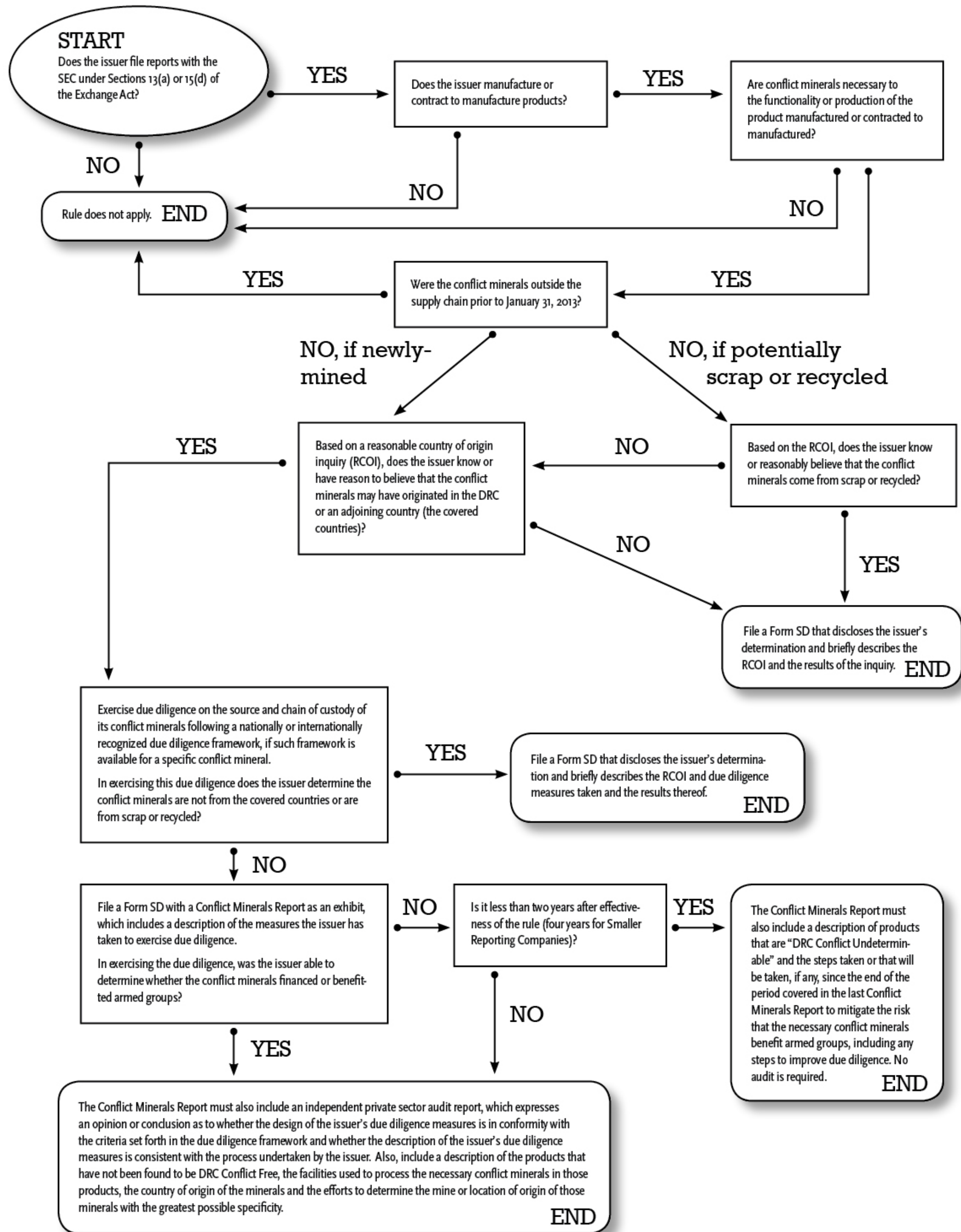
The SEC noted that it is not making reporting companies prove a negative, in that the final rule, unlike the proposed rule, does not make reporting companies prove minerals they use did not originate from Covered Countries. Instead, reporting companies must only conduct due diligence on the minerals and file a Conflict Minerals Report if they know or have reason to believe the minerals originated from Covered Countries.

The final rule, in keeping with the approach set forth in the proposal, also does not require product labels indicating whether a product is considered conflict free or not.

What Are the Reporting Deadlines?

Reporting companies that must file a Form SD must do so by May 31, 2014. No matter what fiscal year a company uses, the first Form SD will be based upon the 2013 calendar year.

See the next page for the flowchart summary of the final rule the SEC included in the final rule release.



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Securities Law ADVISORY
September 5, 2012

SEC Proposes Rules for General Solicitation and Advertising in Private Securities Offerings

The Jumpstart Our Business Startups Act (JOBS Act) required the Securities and Exchange Commission (SEC) to revise its current rules to allow companies issuing securities in a private offering pursuant to Rule 506 of Regulation D of the Securities Act of 1933 (Securities Act) and Rule 144A of the Securities Act to use general solicitation and general advertising—such as newspaper advertisements, communications over television or radio, public websites or seminars in which attendees are invited through a general advertisement—in their offering efforts, as long as the actual purchasers of the securities are accredited investors[1] or reasonably believed to be qualified institutional buyers (QIBs).[2] On August 29, 2012, the SEC proposed the ***following rules*** to implement this directive.

Rule 506(c)

The SEC has proposed a new Rule 506(c), which would permit the use of general solicitation and general advertising to offer and sell securities, provided that:

- all purchasers of securities are accredited investors; and
- the issuer takes *reasonable steps to verify* that purchasers of the securities are accredited investors. [*Italics added*.]

The key concept of "reasonable steps to verify" comes straight from the JOBS Act. Under existing Rule 501(a) (which the SEC does not propose to amend), an accredited investor is defined as a person or entity who meets, or the issuer reasonably believes meets, certain criteria. Although the SEC stated that it anticipated that many practices currently used by issuers in connection with existing Rule 506 offerings to substantiate their "reasonable belief" as to investor status would satisfy the verification requirement proposed for offerings pursuant to Rule 506(c), the "reasonable steps to verify" standard is intended to have a meaning separate from the Rule 501(a) "reasonably believes" requirement.

In determining the reasonableness of the steps that an issuer has taken to verify that a purchaser is an accredited investor, the SEC's proposing release explains that issuers are to consider the facts and circumstances of the transaction. This includes, among other things, the following factors:

- the type of purchaser and the type of accredited investor that the purchaser claims to be;
- the amount and type of information that the issuer has about the purchaser; and
- the nature of the offering, meaning:
  - the manner in which the purchaser was solicited to participate in the offering; and
  - the terms of the offering, such as a minimum investment amount.

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[1] Rule 501(a) of the Securities Act defines an accredited investor as a person or entity who meets, or the issuer reasonably believes meets, certain specified criteria at the time of the sale of the securities.

[2] A qualified institutional buyer is an institution (individuals cannot be QIBs) included within one of the several categories for "accredited investor" in Rule 501 that owns and invests on a discretionary basis at least $100 million in securities of non-affiliated issuers ($10 million for a broker-dealer).

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The proposing release notes that proposing specific verification methods that an issuer must use "would be impractical and potentially ineffective in light of the numerous ways in which a purchaser can qualify as an accredited investor," and could also force issuers to follow steps that were perhaps not appropriate in a certain instance. The SEC gave the example of an issuer that solicits new investors through a widely disseminated social media advertisement, as opposed to an issuer that solicits new investors from a database of pre-screened accredited investors created and maintained by a registered broker-dealer. In the first case, "reasonable steps" would require something more than presenting a box on a questionnaire, whereas in the latter case, it would be reasonable for the issuer to rely on the broker-dealer to have verified an investor's status as an accredited investor.

The proposed rules would preserve the existing portions of Rule 506 as a separate exemption under Rule 506(b), so that companies conducting offerings pursuant to Rule 506—but without the use of general solicitation and general advertising—would not be subject to the new verification rule or the requirement to sell only to accredited investors. (The existing Rule 506 allows for securities to be sold to up to 35 non-accredited investors who meet certain sophistication requirements.)

Rule 144A

Under the proposed rules, securities resold pursuant to Rule 144A could be offered to persons other than QIBs, including by means of general solicitation or general advertising, provided that the securities are sold only to QIBs or persons whom the seller and any person acting on behalf of the seller reasonably believe is a QIB.

Form D

The proposed rules would amend Form D, which issuers must file with the SEC when they sell securities under Regulation D, to add a separate box for issuers to check if they are claiming the new Rule 506(c) exemption. The current Rule 506 box will be relabeled as Rule 506(b).

Integration with Offshore Offerings

The SEC noted that many commentators wanted clarity as to how any amendments to Rule 506 and Rule 144A would affect the Regulation S safe harbor. Currently, Regulation S provides a safe harbor for offers and sales of securities outside the United States, as long as (i) the securities are sold in an offshore transaction and (ii) there are no directed selling efforts in the United States. A general solicitation such as placing an advertisement in a publication with a United States circulation is regarded as a "directed selling effort." The SEC stated that under the proposed rules, concurrent offshore offerings that are conducted in compliance with Regulation S would not be integrated with domestic unregistered offerings that are conducted in compliance with Rule 506 or Rule 144A, as proposed to be amended.

Expedited Rulemaking Process Urged

The JOBS Act required the SEC to implement the changes to Rule 506 and Rule 144A within 90 days from the date of its enactment, which was April 5, 2012. There was some debate, both within the SEC and without, over whether the changes outlined above should have taken the form of an interim final rule instead of a proposal. Several of the SEC commissioners who voted for the proposal urged the SEC staff to have the rule changes ready to enact by the end of 2012. The SEC will seek public comment on the proposed rules for 30 days.

For more information, contact your Alston & Bird LLP attorney or one of the attorneys in the firm's Securities Group.

For other related securities advisories, click here. If you or a colleague would like to receive future *Securities Law Advisories* and *Special Alerts* electronically, please forward your contact information, including your e-mail address, to securities.advisory@alston.com. Be sure to put "*subscribe*" in the subject line.

International Trade & Regulatory ADVISORY

December 20, 2012

SEC Clarifies Reporting Requirements for Certain Activities Relating to Iran and Specially Designated Nationals; DoD, GSA and NASA Issue Interim Procurement Rule to Implement Iranian Sanctions

On August 10, 2012, President Obama signed the Iran Threat Reduction and Syria Human Rights Act of 2012 (the "Act"), which includes a wide array of amendments to the Iran Sanctions Act of 1996 (ISA), the Comprehensive Iran Sanctions, Accountability and Divestment Act of 2010 (CISADA), and other measures designed to prohibit transactions with Iran and persons or entities listed on the U.S. Department of the Treasury's Office of Foreign Assets Control's Specially Designated Nationals and Blocked Persons List (SDNs). As discussed in the comprehensive client advisory that Alston & Bird issued August 1, 2012,[1] the Act contains many problematic provisions.

One of the most troubling new requirements is contained in Section 219 of the Act, which was the subject of Alston & Bird's separate November 19, 2012, client advisory.[2] This provision requires all companies whose stock (including American Depository Receipts (ADRs)) is traded on U.S. stock exchanges to disclose whether they or their "affiliates" have "knowingly" engaged in certain activities involving Iran or SDNs identified in connection with terrorism or the proliferation of weapons of mass destruction. Section 219 also mandates the public disclosure of any such information by the U.S. Securities and Exchange Commission (SEC) and requires that the President initiate an investigation into whether any such disclosed activities are sanctionable. This provision is scheduled to take effect on **February 6, 2013**, meaning that all annual or quarterly reports filed with the SEC on or after that date are subject to Section 219's reporting requirements.

On December 4, 2012, the SEC amended its Compliance and Disclosure Interpretations (C&DI) to provide guidance on compliance with the Section 219 requirements.[3] Overall, the guidance aims for strict compliance. Among other things, the guidance:

- Confirmed that "affiliate" for purposes of Section 219 is governed by the Exchange Act Rule 12b-2 definition, which states that "[a]n 'affiliate' of, or a person 'affiliated' with, a specified person, is a person that directly,

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[1] Available at http://www.alston.com/advisories/international-trade-and-regulatory-advisory-new-sanctions-legislation.

[2] Available at http://www.alston.com/advisories/international-trade-and-regulatory-advisory-congress-finalizes-further-iran-sanctions-legislation.

[3] The C&DI for Section 219 is available at http://www.sec.gov/divisions/corpfin/guidance/exchangeactsections-interps.htm#147.01.

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or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified." This definition has been further and separately interpreted to include, *inter alia*, directors, executive officers and controlling shareholders if the shareholder has the power to direct management and policies of the issuer.

- Confirmed that the term "knowingly" includes *"should have known."*
- Instructed that issuers may not avoid disclosure by filing early reports prior to February 6, 2013.
- Clarified that reports must include all activities conducted during the reporting period, even if they occurred prior to enactment of the Act. For example, an issuer that files an annual report for the fiscal year ending December 31, 2012, is required to disclose activities that took place between January 1, 2012, and December 31, 2012.
- Explained that the exception in Section 219 for otherwise prohibited transactions with the Government of Iran subject to the "specific authorization of a Federal department or agency" includes both general and specific licenses from the Office of Foreign Assets Control ("provided all conditions of the applicable license are strictly observed"), but not authorizations by any foreign government agency.
- Confirmed that if an issuer and its affiliates have not engaged in any covered activities during the relevant time period, the issuer does not need to include a statement to this effect in its periodic report.

Separately, the Department of Defense (DoD), General Services Administration (GSA) and National Aeronautics and Space Administration (NASA) have also taken action in response to the Iran Threat Reduction and Syria Human Rights Act of 2012. On December 10, 2012, DoD, GSA and NASA issued an interim rule amending the Federal Acquisition Regulation (FAR) to immediately require certain certifications in order to implement the Act's expansion of sanctions relating to the energy sector of Iran and Iran's Revolutionary Guard Corps. The rule requires that each prospective government contractor certify that it, and any person owned and controlled by the prospective contractor, does not knowingly engage in one or more of several types of transactions that involve Iran, including:

- The export of sensitive technology to the Government of Iran or any entities or individuals owned or controlled by, or acting on behalf or at the direction of, the Government of Iran.
- Activities described in Section 5 of the Iran Sanctions Act, which relate to the energy sector of Iran and development by Iran of weapons of mass destruction and other military capabilities.
- Significant transactions with Iran's Revolutionary Guard Corps or any of its officials, agents or affiliates. This includes any transaction that exceeds $3,000.

The rule also revises various provisions of the FAR relating to certain remedies, exceptions and waiver requirements. Interested parties should submit written comments to the Regulatory Secretariat on or before February 8, 2013, to be considered in the formulation of a final rule.

* * *

Please direct any questions concerning Section 219 or the above interim rule to Thomas E. Crocker or Chad A. Thompson of Alston & Bird's International Trade & Regulatory Group at thomas.crocker@alston.com (202-239-3318) and chad.thompson@alston.com (202-239-3927), respectively.

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International Trade & Regulatory ADVISORY

December 28, 2012

Office of Foreign Assets Control Amends Its Iranian Transactions and Sanctions Regulations to Authorize Wind-Down Transactions and Extension of Section 218 Deadline Under Iran Threat Reduction and Syria Human Rights Act

On December 26, 2012, the Office of Foreign Assets Control (OFAC) issued its long-anticipated "guidance" on Section 218 of the Iran Threat Reduction and Syria Human Rights Act (ITRSHRA), which applies OFAC sanctions for the first time to U.S.-owned or controlled foreign subsidiaries (see Alston & Bird LLP client advisories of October 10, 2012, and August 1, 2012). The guidance comes in the form of amendments to OFAC's Iranian Transactions and Sanctions Regulations, 31 CFR Part 560 (ITSR). Of particular relevance, the amendments contain a new Section 560.555 which authorizes, from October 9, 2012 through March 8, 2013, all transactions "ordinarily incident and necessary" to the "winding-down of transactions" prohibited by new Section 560.215, provided that the authorized transactions do not involve a U.S. person or occur in the United States. Paragraph (b) of Section 560.555 specifies that this new general license does not authorize any transactions prohibited by Section 560.205 (the latter provision governs reexports of U.S.-origin products by non-U.S. persons and thus those types of transactions would not be authorized). Paragraph (c) of Section 560.555 provides that transactions involving Iranian financial institutions are authorized pursuant to this new general license, but only if the property and interests in property of the Iranian financial institution are blocked solely pursuant to Part 560 (that is, the authorization is limited to non-Government of Iran-owned banks, which are designated on the SDN List with the [IRAN] tag only).

The net effect of the amendments is to authorize "ordinarily incident and necessary" transactions related to the "wind-down" of transactions that are now prohibited as to U.S.-owned or controlled subsidiaries. Neither of these terms is defined in the ITSR, but OFAC has traditionally construed them flexibly, provided the end goal of compliance is being pursued. The March 8 deadline differs from the February 6 deadline stated in the ITRSHRA. OFAC's rulemaking does not explain why the deadline was extended an additional 30 days, but no doubt those affected will welcome the additional grace period.

New Section 560.215 also provides guidance on the meaning of "owned or controlled," "knowingly," and "subject to the jurisdiction of the Government of Iran" in relation to the transactions that are now prohibited as to foreign subsidiaries of U.S. companies. There are no particular surprises in these clarifications. Moreover, the note to Paragraph (a) of Section 560.215 makes clear that a foreign subsidiary, which is now subject to the OFAC prohibitions, can take advantage of general licenses available to a U.S. person under the ITSR and also can apply for specific licenses, including, specifically, Trade Sanctions Reform and Export Enhancement Act (TSRA) licenses, on the same basis as a U.S. person.

* * *

Please direct any questions concerning the above rulemaking to Thomas E. Crocker of Alston & Bird LLP at 202-239-3318 or thomas.crocker@alston.com.

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