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SEC Adopts Say-on-Pay, Say-on-Frequency and Say-on-Golden Parachute Requirements

On January 25, 2011, the Securities and Exchange Commission adopted, by a 3-2 split vote, rules to implement the advisory "say-on-pay," "say-on-frequency" and "say-on-golden parachute" shareholder votes required by Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act as well as related, new disclosure rules and other requirements.

The final rules are being adopted substantially as proposed, with the following more significant changes or clarifications:

Say-on-Pay and Say-on-Frequency

- Although the SEC declined to mandate a form of say-on-pay resolution, the final rules provide a non-exclusive, sample resolution for say-on-pay votes only.

- The final rules amend Rule 14a-8(i)(10) (the "substantial implementation" exclusion) to permit the exclusion of shareholder proposals seeking say-on-pay or say-on-frequency votes only if the shareholders have approved by a majority of votes cast in the most recent say-on-frequency vote, a single frequency (that is, every year, every two years or every three years), and the company has adopted a policy on the frequency of say-on-pay votes that is consistent with that vote. The proposed rules had permitted the exclusion of such shareholder proposals if the company adopted a say-on-frequency policy consistent with the plurality of votes cast rather than a majority.

- The final rules add to Form 8-K a new requirement to amend the Form 8-K filing reporting the results of the company's say-on-frequency vote to disclose, within 150 days after the vote (but in no event later than 60 days before the company's deadline for submission of shareholder proposals under Rule 14a-8), the company's decision in light of such vote, how frequently it intends to provide a say-on-pay vote. The proposed rules had included a similar disclosure requirement in Form 10-Q and 10-K.

- The final rules amend the Compensation Discussion and Analysis (CD&A) rules to require disclosure regarding whether, and if so, how a company has considered the results of the most recent say-on-pay vote on executive compensation. The proposed rules had required disclosure with regard to previous votes generally.

- The final rules clarify that the say-on-pay and say-on-frequency advisory votes apply to an annual meeting of shareholders for which proxies will be solicited for the election of directors, or a special meeting in lieu of such annual meeting, the proxy materials for which are required to include disclosure of executive compensation.

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Say-on-Golden Parachutes

- The final rules provide that, other than in connection with a Rule 13e-3 going-private transaction, third party bidders are not required to comply with the new say-on-golden parachute disclosures. Target companies are, however, required to comply with the disclosure requirements in their Schedule 14D-9 filings in response to third party bids. The proposed rules had required third party bidders to make such disclosures to the extent known, after reasonable inquiry.
- The adopting release confirms that even though certain golden parachute arrangements are beyond the scope of the disclosure requirements of Section 14A(b)(1) of the Exchange Act, the new disclosure rules under Item 402(t) of Regulation S-K may nevertheless require disclosure of golden parachute arrangements not specifically covered by the statute. However, such additional arrangements are not required to be included in the say-on-golden parachute vote.

Pursuant to the Dodd-Frank Act, companies must comply with the say-on-pay and say-on-frequency votes in any proxy statements for shareholder meetings taking place on or after January 21, 2011, notwithstanding that the SEC's rules do not technically become effective until April 4, 2011. The adopting release provides, however, that the SEC will not object if companies comply with certain provisions of the rules ahead of their becoming effective (see discussion below under "Transition Provisions for Say-on-Pay and Say-on-Frequency Requirements").

In contrast to the say-on-pay and say-on-frequency requirements, all public companies must comply with the new say-on-golden parachute and related new disclosure requirements for golden parachute arrangements with respect to applicable proxy, information statement and other schedules and forms initially filed on or after April 25, 2011.

Smaller reporting companies as of January 21, 2011 (including newly public companies that qualify as smaller reporting companies after January 21, 2011) are exempted from the say-on-pay and say-on-frequency requirements until the first annual or other meeting of shareholders at which directors will be elected and for which executive compensation disclosure is required, occurring on or after January 21, 2013. There is no exemption from the say-on-golden parachute and related disclosure requirements for smaller reporting companies.

The final rules do not apply to foreign private issuers. However, we have been advised by the SEC staff that non-U.S. issuers that are subject to the SEC's proxy rules must also comply with all of these new advisory vote requirements, notwithstanding home country obligations to provide a different form of vote on compensation issues.

"Say-on-Pay" and "Say-on-Frequency" Requirements

Say-on-Pay Requirements

New Rule 14a-21(a) under the Exchange Act requires U.S. public companies to provide their shareholders with an advisory vote on executive compensation for the first annual or other meeting of shareholders at which directors will be elected on or after January 21, 2011 (or on

or after January 21, 2013 in the case of smaller reporting companies), and at least once every three calendar years thereafter.

The say-on-pay vote must relate to all of the compensation required to be disclosed by Item 402 of Regulation S-K with respect to the named executive officers (NEOs), including the CD&A required under Item 402(b) and the compensation tables and other narrative executive compensation disclosures. While a company may choose to provide separate votes on components of the NEO compensation disclosures, the votes, taken together, must cover all of the compensation arrangements required to be disclosed pursuant to Item 402. Thus, for example, a vote to approve only compensation policies and procedures would be insufficient. The vote would not apply to director compensation or to disclosure regarding the company's compensation policies and practices as they relate to risk management and risk-taking, unless such risk considerations are a material aspect of the company's compensation policies or decisions and are discussed in the company's CD&A. While the SEC continues to decline to mandate a prescribed form of say-on-pay shareholder resolution, the final rules include the following as a non-exclusive example of a shareholder resolution that would comply with the rules:

> "RESOLVED, that the compensation paid to the company's named executive officers, as disclosed pursuant to the Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion is hereby APPROVED."

In addition to implementing the say-on-pay vote required by the Dodd-Frank Act, the SEC also amended Item 402(b) of Regulation S-K to require companies to address in the CD&A whether, and if so, how, they have considered the results of their most recent say-on-pay vote and how that consideration has affected their compensation policies and decisions. The proposed revision to Item 402(b) contemplated disclosure of the company's consideration of any previous say-on-pay votes, but the final rule limited the analysis to only the most recent say-on-pay vote so as to provide shareholders with helpful additional information while avoiding boilerplate disclosure listing all previous votes. Companies may, to the extent material, describe their consideration of earlier say-on-pay votes.

Say-on-Frequency Requirements

New Rule 14a-21(b) requires that companies, for the first annual or other meeting of shareholders at which directors will be elected on or after January 21, 2011 (or on or after January 21, 2013 in the case of smaller reporting companies), and at least once every six calendar years thereafter, provide their shareholders with an advisory vote to determine whether the say-on-pay vote should occur every one, two or three years. The final rules do not include an example of a compliant say-on-frequency shareholder resolution.

The final rules amend Rule 14a-4's proxy card requirements to allow shareholders a choice among one, two or three years for the frequency of the say-on-pay vote and a choice to abstain. Companies may recommend a particular frequency for the say-on-pay vote, but must clarify that shareholders are not voting to approve or disapprove the company's recommendation. In addition, the adopting release provides that companies may vote uninstructed proxy cards in line with management's recommendation, so long as they follow existing Rule 14a-4 requirements to (i) include a recommendation for the frequency of say-on-

pay votes in the proxy statement, (ii) permit abstention on the proxy card and (iii) include language regarding how uninstructed shares will be voted in bold on the proxy card.

Consistent with existing rules, the results of the say-on-frequency and say-on-pay votes and any other matters submitted to a vote of shareholders must be disclosed on Form 8-K within four business days. Due to the unique nature of the choices for the say-on-frequency vote, Item 5.07(b) is amended to facilitate the reporting of the results of these votes by requiring a company to disclose the number of votes cast for each of the say-on-frequency options of one, two and three years, as well as the number of abstentions (in lieu of the typical disclosure of the number of votes cast for, against and withheld and the number of abstentions and broker non-votes). The final rules further add a new Item 5.07(d) of Form 8-K, which requires a company to amend its Form 8-K reporting the results of its say-on-frequency vote to disclose its final determination regarding the frequency of its say-on-pay votes within 150 calendar days after the date of the end of the annual or other meeting at which the say-on-frequency vote took place, but no later than 60 calendar days before the company's deadline for submission of Rule 14a-8 shareholder proposals for the subsequent annual meeting. The proposed rules had included a similar disclosure requirement in the Forms 10-Q and 10-K instead. The adopting release reminds companies that failure to file a timely report required by Item 5.07 will result in the loss of their Form S-3 eligibility.

Rules Relating to Both Say-on-Pay and Say-on-Frequency

The say-on-pay and say-on-frequency votes are not binding on a company or its board of directors, cannot be construed as overruling any decision of the company or its board and do not change or add to the fiduciary duties of the company or its board. However, the final rules amend Rule 14a-8(i)(10) to allow the exclusion of shareholder proposals that seek a present or future say-on-pay vote or that relate to the frequency of say-on-pay votes, but only if shareholders have approved in the most recent say-on-frequency vote, by a majority of votes cast, a single frequency (i.e., every year, every two years or every three years), and the company has adopted a policy on the frequency of say-on-pay votes that is consistent with that vote. The proposed rules would have permitted the exclusion of such shareholder proposals if the company adopted a policy on say-on-frequency that was consistent with the frequency approved by a plurality of shareholders even where no frequency received a majority of votes cast.

The final rules add new Item 24 of Schedule 14A that requires companies to disclose that they are providing the say-on-pay and say-on-frequency votes, as applicable, and briefly explain the general effect of each vote, such as whether each such vote is non-binding. In a modification from the proposed rules, the final rules also require companies to disclose the current frequency of say-on-pay votes (as determined by the board of directors following a shareholder advisory vote) as well as when the next say-on-pay vote is scheduled to occur. The adopting release clarifies that the SEC does not expect such disclosures for the meeting where a company initially conducts the say-on-pay and say-on-frequency votes.

The final rules amend Rule 14a-6 to specify that the inclusion in a proxy statement of a solicitation with respect to any advisory vote on executive compensation (including a say-on-pay or say-on-frequency vote, even if such a vote is included on a voluntary basis and not pursuant to Rule 14a-21 requirements) would not trigger a preliminary filing of proxy materials

with the SEC (so long as any other matters to which the solicitation relates include only the other matters specified by Rule 14a-6(a)).

The adopting release confirms that broker discretionary voting of uninstructed shares will not be permitted for the say-on-pay and say-on-frequency votes.

Also, because companies with outstanding indebtedness under the Troubled Asset Relief Program are already required to provide an annual say-on-pay vote, they are exempt from the say-on-frequency requirement until such companies have repaid all indebtedness under TARP.

Transition Provisions for Say-on-Pay and Say-on-Frequency Requirements

The adopting release reiterates the guidance relating to the application of some of the adopted rules before their effective date of April 4, 2011. Among other things, the adopting release states that the SEC will not object if prior to the effective date:

- Companies do not file proxy material in preliminary form if the only matters that would require a filing in preliminary form are the say-on-pay vote and say-on-frequency vote required by Section 14A(a) of the Exchange Act;
- The form of proxy card for the say-on-frequency vote enables shareholders the opportunity to specify by boxes a choice among one, two or three years, or abstain; and
- An issuer with outstanding indebtedness under the Trouble Asset Relief Program does not include a say-on-frequency vote in its proxy statement for its annual meeting, provided it fully complies with its say-on-pay voting obligations under the Emergency Economic Stabilization Act of 2008.

Further, for proxy materials filed for meetings to be held on or before December 31, 2011, the form of proxy card for the say-on-frequency vote may allow shareholders the opportunity to specify by boxes a choice among one, two or three years, and there is no discretionary authority to vote proxies where the shareholder has not selected a choice among those three options, instead of the four options of one, two or three years or abstain as required by amended Rule 14a-4.

"Say-on-Golden Parachute" and Additional Disclosure of Golden Parachute Arrangements

Say-on-Golden Parachute Requirements

New Rule 14a-21(c) requires a company soliciting shareholder approval of an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all of its assets to provide a separate advisory say-on-golden parachute vote on any agreements or understandings and compensation disclosed pursuant to new Item 402(t) of Regulation S-K (discussed below), unless such agreements or understandings have been subject to a prior say-on-pay vote. The adopting release clarifies that companies are required to provide a say-on-golden parachute vote only when seeking approval of the business combination

transaction itself, and not with respect to other proposals even if they are necessary to effect the business combination transaction (such as an increase in authorized shares or a reverse stock split).

The say-on-golden parachute vote is required only for those arrangements that must be disclosed pursuant to Section 14A(b)(1) of the Exchange Act, which requires all persons soliciting shareholder approval of an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially of an issuer's assets to provide disclosure of any agreements or understandings that the soliciting person has with its NEOs or the NEOs of the acquiring issuer (if the issuer is not the acquiring issuer) concerning compensation that is based on or otherwise relates to the business combination transaction. Accordingly, final Rule 14a-21(c) and the adopting release specify that any agreements or understandings between an acquiring company and the NEOs of the soliciting target are not subject to the say-on-golden parachute vote (even if such arrangements and understandings are nonetheless required to be disclosed under Item 402(t) of Regulation S-K).

In order for a company to take advantage of the exception from the say-on-golden parachute vote for golden parachute arrangements that were subject to a prior say-on-pay vote, the executive compensation disclosure subject to the prior vote must have included Item 402(t) disclosure of the same golden parachute arrangements. Thus, companies may alternatively seek approval of such golden parachute arrangements as part of their general say-on-pay vote, but any changed or new arrangements must be approved by shareholders in a separate say-on-golden parachute vote (and must be disclosed in accordance with Item 402(t)). The adopting release states that the following actions are considered a change in terms requiring an additional say-on-golden parachute vote: (i) any change that would result in an Internal Revenue Code "Section 280G tax gross-up" becoming payable[1], (ii) changes in compensation because of a new named executive officer, (iii) additional grants of equity compensation in the ordinary course and (iv) increases in salary. However, if any changes would result only in a reduction in value of the total compensation payable or if the disclosure under Item 402(t) has been updated to change only the value of the items in the tabular disclosure to reflect price movements in the company's securities (unless an IRC Section 280G tax gross-up becomes payable to an NEO as a result of such increase in the company's share price), no new say-on-golden parachute vote would be required.

As with the say-on-pay and say-on-frequency votes, the say-on-golden parachute vote is not binding. Similarly, new Item 24 of Schedule 14A requires companies to disclose that they are providing the say-on-golden parachute vote and briefly explain the general effect of the vote, such as whether the vote is non-binding. The final rules do not include any prescribed (or example) form of say-on-golden parachute resolution.

Item 402(t) Disclosure

The disclosures required under new Item 402(t) of Regulation S-K are generally more expansive than the currently required disclosures of golden parachute arrangements under existing Item 402(j) of Regulation S-K and Item 5 of Schedule 14A (Interest of Certain Persons in Matters to Be Acted Upon). Among other things, new Item 402(t) does not include a *de minimis* exception for perquisites and requires disclosure of all golden parachute

[1] Although commonly referred to as a "280G tax gross-up", the excise tax to which the gross-up relates is actually imposed under Section 4999 of the Internal Revenue Code.

arrangements, including those that do not discriminate in favor of executive officers or directors and that are available generally to all salaried employees.

Under new Item 402(t), companies are required to provide tabular disclosure with respect to each NEO of the acquiring and target companies for which such disclosure is required of any written or unwritten golden parachute arrangements between the NEO and the acquiring or target company, including disclosure of the aggregate dollar value of the following items:

- Cash severance payments, including but not limited to payments of base salary, bonus and pro-rated non-equity incentive compensation plan payments;
- Stock awards for which vesting would be accelerated, in-the-money option awards for which vesting would be accelerated and payments in cancellation of stock and option awards;
- Pension and nonqualified deferred compensation benefit enhancements;
- Perquisites and other personal benefits or property, and health care and welfare benefits (including a requirement that the value of health care benefits be determined based on the assumptions used for financial reporting purposes under GAAP);
- Tax reimbursements (such as IRC Section 280G tax gross-ups);
- Any other compensation that is based on or otherwise relates to the transaction that is not properly reported in any of the foregoing items; and
- The sum of all such payments.

For all of the foregoing disclosures, companies must include footnote disclosure quantifying the amount payable upon the occurrence of the subject transaction (single-trigger arrangements) and those that are contingent on an additional condition, such as termination of employment without cause or resignation for good reason (double-trigger arrangements). For double-trigger arrangements, companies are required to specify the period of time in which such termination or resignation must occur for the amount to become payable. For each category of golden parachute compensation, companies must include footnote disclosure quantifying each separate form of compensation included in the totals reported (other than the overall total of golden parachute compensation), such as the identification and quantification of all perquisites and other personal benefits or property as is currently required in the Summary Compensation Table filed in annual proxy statements and Forms 10-K.

For purposes of calculating dollar amounts based on company stock price, if shareholders are to receive a fixed dollar amount, the price per share shall be that fixed dollar amount. Otherwise, the price per share shall be the average closing market price of the company's securities over the first five business days following the first public announcement of the applicable transaction.

For purposes of Item 402(t), the disclosures apply only to persons treated as NEOs under Item 402(a)(3)(i), (ii) and (iii) of Regulation S-K (excluding those individuals who are otherwise treated as NEOs for purposes of Item 402 because they would have been among the most

highly compensated executive officers but for the fact that they were not serving as an executive officer at the end of the last completed fiscal year). Similar to the approach taken by Item 5.02 of Form 8-K in determining who is to be considered a company's NEOs, the instructions to Item 402(t) specify that the determination of who is an individual covered by Items 402(a)(3)(i), (ii) and (iii) of Regulation S-K should be made with respect to those executive officers for whom disclosure was required in the company's most recent filing with the SEC under the Securities Act or Exchange Act that required disclosure pursuant to Item 402(c) of Regulation S-K.

A company that had previously sought approval of golden parachute arrangements at an annual meeting, but which later seeks approval of new or revised arrangements, must provide two separate tables, one that discloses all golden parachute compensation and another that discloses only the new or revised arrangements. Further, if the Item 402(t) disclosure is different from the compensation subject to a say-on-golden parachute vote pursuant to Rule 14a-21(c), the company must provide a separate table for those arrangements that are subject to the say-on-golden parachute vote. For example, when disclosure is needed of arrangements between an acquiring company and the NEOs of the soliciting target company, one table must be used to disclose all golden parachute compensation, whether in connection with agreements with the target or the acquiring company, and another table must be used to disclose the compensation in connection with agreements with the target company that is subject to the advisory vote.

Companies must also provide a narrative description of any material factors necessary to an understanding of each arrangement disclosed in the table, including the specific circumstances that would trigger payment, whether the payments would or could be lump sum or annual, the duration of such payments, by whom the payments would be made and any material conditions or obligations applicable to the receipt of the payments (such as non-compete, non-solicitation, non-disparagement or confidentiality agreements; their duration and provisions regarding their waiver or breach).

The adopting release notes that Item 402(t) requires tabular and narrative disclosure only of compensation that is based on or otherwise relates to the proposed transaction. As such, Item 402(t) does not require separate disclosure or quantification with respect to compensation already disclosed in the Pension Benefits Table and Nonqualified Deferred Compensation Table, previously vested equity awards or bona fide post-transaction employment agreements to be entered into in connection with the transaction (as the SEC states in the adopting release that it does not view such future employment arrangements as compensation "that is based on or otherwise relates to" the transaction). The SEC does note that information regarding such future employment arrangements is subject to disclosure under Item 5(a) and Item 5(b)(xii) of Schedule 14A to the extent such arrangements constitute a "substantial interest" in the matters to be acted upon.

Finally, except with respect to Schedule TO for third party tender offers, the SEC has added the above disclosure requirements to all business combination related forms by amending Item 1011(b) of Regulation M-A and the specific forms directly as required so that disclosures are conformed regardless of the structure of the proposed transaction. In particular, these disclosure requirements were added to Schedule 13E-3 (for going-private transactions), Schedule 14A (for proxy solicitations in both contested and uncontested situations), Schedule 14C (for information statements) and Schedule 14D-9 (for tender offers). Because third party

bidders may not have access to the information necessary to make these disclosures, the SEC is not requiring such persons to comply with the foregoing disclosure requirements. However, because the target company will be required to include such information in its Schedule 14D-9, shareholders will not be disadvantaged by the failure to include such a requirement for the third party bidder on Schedule TO.

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For a copy of the say-on-pay, say-on-frequency and say-on-golden parachute adopting release, see http://www.sec.gov/rules/final/2011/33-9178.pdf.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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