

Corporate and Securities Alert

“Say on Pay” Final Rules

JANUARY 27, 2011

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Summary

On January 25, 2011, the SEC issued final rules (“Final Rules”) designed to implement provisions of the Dodd-Frank Act relating to shareholder approval of executive compensation and golden parachute compensation arrangements. The Final Rules closely track the proposed rules that the SEC released in late 2010, and apply beginning with the 2011 proxy season.

The Dodd-Frank Act requires all public companies, beginning with shareholder meetings taking place on or after January 21, 2011 at which directors are elected, to:

- Conduct a shareholder advisory vote to approve the compensation of named executive officers — a “Say on Pay Vote” — at least once every three calendar years;
- Conduct a shareholder advisory vote to determine whether the Say on Pay Vote should be taken every one, two or three calendar years — a “Frequency Vote” — at least once every six calendar years; and
- Conduct a shareholder advisory vote to approve named executive officer compensation arrangements in connection with an acquisition transaction — a “Golden Parachute Vote” — unless those arrangements were previously subject to an annual Say on Pay Vote.

These shareholder votes are advisory only — the results are not binding on the company or its board of directors.

The Final Rules require a company to disclose whether and, if so, how it has considered the results of the most recent Say on Pay Vote, and how that consideration affected its executive compensation decisions and policies. Companies will also disclose the current frequency of Say on Pay Votes and when the next such vote will occur.

When must we first conduct the Say on Pay Vote, Frequency Vote and Golden Parachute Vote?

Companies are required to include the Say on Pay Vote and the Frequency Vote in proxy statements for meetings at which directors are elected that take place on or after January 21, 2011. The new rules are not effective until 60 days after publication in the Federal Register, but companies with meetings in that transition period should look to the new rules for implementation guidance.

A Golden Parachute Vote will be required for change of control transactions initially filed with the SEC on or after April 25, 2011.

Smaller reporting companies were granted a two-year temporary exemption for the Say on Pay Vote and the Frequency Vote. These companies will first be required to include the votes in proxy statements for shareholder meetings at which directors are elected that take place on or after January 21, 2013. However, smaller reporting companies must conduct Golden Parachute Votes for acquisition transactions initially filed with the SEC on or after April 25, 2011, like other issuers.

Newly-public companies are not exempt from the new rules, so they must include the Say on Pay Vote and Frequency Vote in the proxy statement for at the first annual meeting after the initial public offering (except smaller reporting companies).

What compensation does the Say on Pay Vote cover?

Shareholders will be asked to approve the compensation of the company’s named executive officers (“NEOs”), as such compensation is disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis (“CD&A”), compensation tables and related narrative executive compensation disclosure. Narrower votes, such as a vote to approve the company’s CD&A or its compensation philosophy, will not satisfy the requirement.

The company’s disclosure about any risks associated with its employee compensation programs generally — which is not part of the executive compensation disclosure — is not covered by the Say on Pay Vote. However, if incentive structure and risk management considerations are a material aspect of executive compensation, the company should address it in the CD&A, which would be covered by the Say on Pay Vote.

With the advent of Say on Pay Votes, the primary purpose of executive compensation disclosure — particularly the CD&A — shifts from disclosure compliance to shareholder communication. It is still important that executive compensation disclosure be accurate and complete, and it is increasingly important that it be responsive to shareholder interests, clearly and convincingly presenting the company’s executive compensation philosophy, programs and implementation.

What is the Frequency Vote?

The Frequency Vote is a non-binding advisory shareholder vote on whether the Say on Pay Vote should occur every 1, 2, or 3 years. The Frequency Vote must be conducted no less often than once every six calendar years.

The Final Rules require that shareholders must be given four choices for a Frequency Vote: every year, every other year or every third year, or to abstain from voting on the matter. If no choice is selected by a shareholder, the proxy may be voted in accordance with management's recommendation only if the company includes its recommendation in the proxy statement, permits abstention on the proxy voting card and includes language regarding how uninstructed shares will be voted on the proxy voting card.

What disclosures are required in connection with the Say on Pay Vote and Frequency Vote?

Proxy Statement. The Final Rules require that a company include CD&A disclosure of whether and, if so, how it has considered the results of its most recent Say on Pay Vote. The rules also require CD&A disclosure about how the company's consideration of the most recent Say on Pay Vote affected its executive compensation decisions and policies. A company may disclose whether and how it took into consideration earlier Say on Pay Votes, if material to the compensation policies and decisions discussed. The Final Rules also require proxy statement disclosure (outside of CD&A) of the current frequency of Say on Pay Votes and when the next such vote will occur.

Form 8-K. Companies are already required to report the results of shareholder voting under Item 5.07 of Form 8-K, which is due within four business days after the meeting. The Final Rules amend Item 5.07 to require the company, following any Frequency Vote, to disclose its decision as to how frequently it will include Say on Pay Votes in the future, in light of that vote. The disclosure is required no later than 150 calendar days after the date of the meeting at which the Frequency Vote took place, and in any event no later than 60 calendar days prior to the deadline for submission of Rule 14a-8 shareholder proposals for the next annual meeting.

Can shareholders still submit proposals that seek a shareholder vote on executive pay or that relate to the frequency of shareholder votes on executive pay?

Yes, but the company may exclude shareholder proposals on these matters if the company has adopted a policy on frequency of Say on Pay Votes that is that same as what a majority of the company's shareholders approved in the most recent Frequency Vote. Please note that if the Frequency Vote does not result in a majority vote for one of the three alternatives, then future shareholder proposals on these

topics cannot be excluded, even if the company selects the frequency preferred by the largest shareholder vote.

When is a Golden Parachute Vote (and related disclosure) required?

A Golden Parachute Vote will be required for any company involved in a proxy or consent solicitation relating to a change of control transaction initially filed with the SEC on or after April 25, 2011. This includes any acquisition, merger, or proposed sale of all or substantially all of a company's assets, including going-private transactions and third-party tender offers.

Required disclosures relate to all written or unwritten agreements or understandings that the target company and the acquiring company have with the NEOs of each company, if those agreements or understandings are based on or related to the change of control transaction. Target company compensation arrangements with its NEOs that are related to a change of control transaction would be disclosed in the target company proxy statement that solicits shareholder approval of the acquisition, and would be subject to a Golden Parachute Vote. Change of control related compensation under arrangements between the acquiring company and the target company NEOs would need to be disclosed in the target company proxy statement, but no shareholder vote would be required with respect to those arrangements. If the acquiring company solicits approval of the transaction by its own shareholders, it would disclose transaction-related compensation for its NEOs, and a Golden Parachute Vote with respect to those arrangements would be required.

The new disclosure includes tabular and narrative material. The table requires, for each named executive officer, the aggregate dollar value of:

- Cash severance payments (salary, bonus, cash incentive plan, etc.)
- Accelerated equity awards and payments in cancellation of equity awards (calculated based on the change of control's agreed price per share, or the average closing price per share over the first five business days following the first public announcement of the change of control)
- Pension and nonqualified deferred compensation benefit enhancement
- Health & welfare benefits, perquisites (even if de minimis) and other personal benefits
- Tax reimbursements (e.g., 280G gross-ups)
- Other (for any compensation not captured by the foregoing)
- Aggregate dollar value of the foregoing

The table would include footnotes quantifying each separate form of compensation included in the aggregate amounts above, with perquisites and personal benefits identified and quantified. Footnotes would also quantify the amounts payable under “double-trigger” arrangements (specifying the post-change of control termination time frame) and “single-trigger” arrangements.

Narrative disclosure would describe material factors necessary to understand each compensatory arrangement quantified in the table. Triggering events must be described, payment schedules disclosed and any material conditions to the payment identified, including the terms of non-competition agreements. No exception is made for arrangements that do not discriminate in favor of executives and that are generally available to all employees, or for *de minimis* perquisites or other personal benefits.

The Final Rules do not require disclosure of payments that are independent of the change of control transaction (such as the right to payments that have previously vested), nor does it require disclosure of any bona-fide compensation payable pursuant to any post-transaction employment agreement.

Is there any way to avoid a Golden Parachute Vote?

The Final Rules implement the Dodd-Frank Act exemption from the Golden Parachute Vote requirement if the arrangements have already been described and subject to a prior annual Say on Pay Vote, but only if the required tabular and narrative disclosure referred to above has been provided. However, if the golden parachute arrangements that were previously disclosed and voted upon have been modified or expanded (including by virtue of a new award), new disclosure and a new Golden Parachute Vote would be required in the event of a change of control transaction. Reducing or eliminating such compensation that had already been subject to a Say on Pay Vote would not require a new Golden Parachute Vote.

Are we required to use any particular form of language for any of the three shareholder advisory votes?

No. However, a vote to approve a proposal on a different matter, such as a vote to approve only compensation policies and procedures, will not satisfy the requirements.

The SEC provided the following non-exclusive example of a resolution that would satisfy the requirements for a Say on Pay Vote resolution:

“RESOLVED, that the compensation paid to the company’s named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion

and Analysis, compensation tables and narrative discussion, is hereby APPROVED.”

No exemplary resolution language was provided for the Frequency Vote or the Golden Parachute Vote.

Is broker discretionary voting permitted on a Say on Pay Vote or a Frequency Vote?

No, and broker discretionary is already prohibited in connection with acquisition transactions.

Are we required to file a preliminary proxy statement because we include a Say on Pay Vote or a Frequency Vote?

No.

Are smaller reporting companies exempted from these rules?

No. However, as noted above, the Say on Pay Vote and the Frequency Vote will not be required for smaller reporting companies until the first shareholders’ meeting at which directors are elected taking place on or after January 21, 2013. Smaller reporting companies, however, must conduct Golden Parachute Votes effective immediately for acquisition transactions initially filed with the SEC on or after April 25, 2011, as do all other issuers.

Are newly public companies exempted from these rules?

No, but if they qualify as smaller reporting companies they will be able to follow the delayed timing of the Say on Pay Vote and the Frequency Vote noted above.

Action Items?

Say on Pay is here, but there will be little guidance available for some time because the rules are new and sample disclosures are few. However, companies should clearly consider these issues:

- Think through how often you want to hold a Say on Pay Vote, and support this management recommendation with explanations that shareholders will find persuasive.
- Concentrate on making your CD&A more readable and more informative about why executive compensation is structured as it is and how the company’s executive compensation was determined, with the objective of persuading shareholders to understand and support the Compensation Committee’s executive compensation decisions and policies.
- Defer any effort to take advantage of the Golden Parachute Vote exception until more companies have experimented with different approaches. For most companies it is unlikely at this point that adding golden parachute disclosure as part of a Say on Pay Vote will be sufficient to avoid a future Golden Parachute Vote in the event of a subsequent change of control transaction.

For more information on these or related matters, please contact Scott Spector or Horace Nash.

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