

Corporate and Securities Alert:

“Say on Pay” Rules Proposed

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Fenwick
FENWICK & WEST LLP

Summary

The SEC has released a rule proposal (“Proposal”) designed to implement provisions of the Dodd-Frank Act relating to shareholder approval of executive compensation and golden parachute compensation arrangements. We believe the final rules will closely track the Proposal, so issuers preparing proxy statements now should draft with the Proposal in mind. Proxy statements for meetings on or after January 21, 2011 are affected.

The Dodd-Frank Act requires all public companies to:

- Conduct a shareholder advisory vote to approve the compensation of named executive officers – a “Say on Pay Vote” – at least once every three years;
- Conduct a shareholder advisory vote to determine whether the Say on Pay Vote should be taken every 1, 2 or 3 years – a “Say on Pay Frequency Vote” – at least once every six 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 a Say on Pay Vote.

These shareholder votes are advisory only – the results are not binding on the company or its board of directors. However, the Proposal includes requirements that the company disclose whether (and how) it has considered results of past Say on Pay Votes and Golden Parachute Votes, and how frequently it will hold Say on Pay Votes in the future.

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 described in the Compensation Discussion and Analysis (“CD&A”), the compensation tables and other narrative disclosure of executive compensation. The vote must relate to all of the company’s required executive compensation disclosures, so narrower votes, such as a vote to approve the company’s CD&A or compensation philosophy, will not satisfy the requirement.

The company’s analysis of any risks associated with its general compensation programs – which is generally outside of the executive compensation disclosure – would not be covered by the Say on Pay Vote. However, if incentive

structuring and risk management considerations are a material aspect of NEO compensation that a company wishes to address, it should do so in the CD&A, which would then be disclosure considered in connection with 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 information and persuasion. It is still important that executive compensation disclosure be accurate and complete, but now it is also important that it be responsive to shareholder interests, and clearly and convincingly present the company’s thinking behind its executive compensation policies and decisions.

What is the Say on Pay Frequency Vote?

The Say on Pay Frequency Vote allows shareholders to vote on whether the Say on Pay Vote should in their view occur every 1, 2, or 3 years. The Say on Pay Frequency Vote must be conducted no less frequently than once every six years.

The Proposal requires that shareholders must be given four choices for a Say on Pay Vote: every year, every other year or every third year, or to abstain from voting on the matter. Until final rules are issued, companies may omit the abstention – if no choice is selected by a shareholder, the proxy will not be voted.

When do proxy statements first have to include a Say on Pay Vote and a Say on Pay Frequency Vote?

The initial Say on Pay Vote and Say on Pay Frequency Vote must be included in proxy statements for annual or other meetings of shareholders occurring on or after January 21, 2011. This is the case whether or not the SEC has adopted final rules to implement these provisions of the Dodd-Frank Act. Proxy statements for annual meetings of companies with fiscal years ending on September 30, 2010 will likely be the first proxy statements to include this material.

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

The Proposal requires that a company report in its CD&A whether the company has taken into account the results of previous Say on Pay Votes when making its compensation policies and decisions – and, if so, how. In the first year, this disclosure might be prospective only; it is not clear whether

in future years the staff will expect commentary only on the most recent Say on Pay Vote, or something broader.

The Proposal also requires the company to disclose (in its next Form 10-Q or Form 10-K, as applicable) its decision about how frequently it will conduct future Say on Pay Votes. Because it is advisory, the company can choose to follow the shareholder vote or not, but would be well advised to explain its reasons for selecting a frequency other than that preferred by the largest number of shareholders.

The Form 8-K requirement that companies disclose results of shareholder voting within four business days following the day the shareholder meeting ends were not changed by the Proposal, so it applies to these votes.

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

No.

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 companies would be permitted to exclude shareholder proposals on these matters if they were already substantially implemented. Specifically, such proposals may be excluded if the company has adopted a policy on frequency of Say on Pay Votes that is consistent with the plurality of votes cast in the most recent Say on Pay Frequency Vote.

When is a Golden Parachute Vote required?

The Proposal requires that public companies make new disclosures in connection with proxy or consent solicitations relating to change of control transactions. This would include 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 an acquisition 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. Acquisition-related compensation under arrangements between the acquiring company and 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 would include tabular and narrative material. In the table, the following compensatory elements must be separately quantified and totaled:

- Cash severance payments (salary, bonus, cash incentive plan, etc.)
- Dollar value of accelerated equity awards and payments in cancellation of equity awards (calculated based on the issuer's stock price as of the latest practicable date)
- Dollar value of 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)

This material must be presented in tabular format (payments under "single-trigger" and "double-trigger" arrangements must be separately identifiable – such as through footnote references).

The required narrative disclosure would describe material conditions and obligations to any present, deferred or contingent compensation. Triggering events must be described and all material factors regarding each arrangement will be required to be disclosed. Payment schedules must be discussed and the party making the payments must be identified. 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 and other personal benefits. The Proposal does not require disclosure of payments attributable to amounts that are vested regardless of the change of control transaction, 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 Proposal includes rules implementing the Dodd-Frank Act exemption from the Golden Parachute Vote requirement if the arrangements have already been subject to a prior Say on Pay Vote. 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.

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

No.

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

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

Are smaller reporting companies exempted from these rules?

No.

Action Items?

Say on Pay is here, and companies that have meetings in late January or early February will not have much guidance available because the rules will be new and sample disclosures will be few. However, companies should clearly consider these issues:

- Think through how often you want to hold a Say on Pay Vote, and support a 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 the SEC's rule-making on this aspect of the Proposal is final, and 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.

Scott P. Spector (650.335.7251 – sspector@fenwick.com)

Horace Nash (650.335.7934 – hnash@fenwick.com)

Blake W. Martell (650.335.7606 – bmartell@fenwick.com)

Elizabeth A. Gartland (415.875.2361 – egartland@fenwick.com)

John E. Ludlum (650.335.7872 – jludlum@fenwick.com)

Nicholas F. Frey (650.335.7882 – nfrey@fenwick.com)

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