

# Client Alert.

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## New Golden Parachute Compensation Disclosure and Shareholder Advisory Vote Requirements

By Michael G. O'Bryan, David M. Lynn, and Scott G. Hodgdon

The Securities and Exchange Commission's (the "SEC") new disclosure and advisory vote requirements for compensation based on or relating to merger and similar transactions, often referred to as golden parachute arrangements, became effective for proxy statements and other acquisition related filings initially filed on or after April 25, 2011. The SEC adopted the rules to implement Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").<sup>1</sup> Now that the new golden parachute compensation requirements are effective, we wanted to offer some considerations for compliance with the new requirements as well as provide discussion of some practical issues that may arise in preparing the new disclosure.

### THE NEW DISCLOSURE AND VOTING REQUIREMENTS

The SEC adopted new Rule 14a-21(c), which provides that if a solicitation is made by the issuer for a meeting of shareholders at which the shareholders are asked to approve an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all assets of the issuer, then the issuer must provide a separate shareholder vote to approve any agreements or understandings disclosed pursuant to Item 402(t) of Regulation S-K. However, as described below, if such agreements or understandings have been subject to a shareholder advisory vote under Rule 14a-21(a) (the "Say-on-Pay" vote), then a separate shareholder vote is not required.

New Item 402(t) of Regulation S-K requires disclosure of named executive officers' golden parachute arrangements in a new Golden Parachute Compensation Table, together with accompanying footnotes and narrative disclosure. The table requires quantification of cash severance payments, the value of equity awards that are accelerated or cashed out, pension and nonqualified deferred compensation enhancements, perquisites, and other personal benefits; and tax reimbursements. The table requires quantification with respect to any type of compensation, whether present, deferred, or contingent, that is based on or relates to a merger or similar transaction.

In addition to merger proxies on Schedule 14A where a shareholder advisory vote on golden parachutes will also typically be required, the new golden parachute compensation disclosure is also required in other forms and schedules. These include certain information statements on Schedule 14C, registration statements on Forms S-4 and F-4, and Schedules 13E-3 and 14D-9 in connection with going-private and tender offer transactions. As such, the new golden parachute disclosure will be required not only in connection with the approval of merger and similar transactions, but also in information statements relating to mergers and similar transactions, proxy or consent solicitations that do not contain merger proposals but require disclosure of information under Item 14 of Schedule 14A pursuant to Note A of Schedule 14A, registration statements relating to mergers and similar transactions, going-private transactions on Schedule 13E-3 and third-party tender offer solicitation/recommendation statements on Schedule 14D-9.

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<sup>1</sup> Our January 31, 2011 news bulletin describing the Say-on-Pay and golden parachute rules is available at <http://www.mofo.com/files/Uploads/Images/110131-SEC-Adopts-Say-on-Pay-Rules.pdf>.

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## **SAY-ON-PAY VOTE – AN EXCEPTION TO THE SAY-ON-GOLDEN PARACHUTE VOTING REQUIREMENT**

Issuers that wish to take advantage of the possibility to exclude a shareholder advisory vote on golden parachute compensation in connection with a future vote on a merger or similar transaction must voluntarily include the Item 402(t) tabular and narrative disclosures in annual meeting proxy statements at which a Say-on-Pay vote will be held. If there are changes to the arrangements after the date of the annual meeting or if new arrangements are entered into that were not subject to a prior Say-on-Pay vote, then a separate shareholder advisory vote on the golden parachute compensation will still be required. In that case, the vote is required only with respect to the amended golden parachute payment arrangements. Other than changes that result only in a reduction in the amount of golden parachute compensation or that arise because of a change in the stock price, any other change to the golden parachute arrangements after the Say-on-Pay vote will trigger the requirement for a new vote.

Based on the filings thus far this proxy season, it is unlikely that companies will often use the Say-on-Pay vote exception.<sup>2</sup> In the months since the requirement for a mandatory Say-on-Pay vote became effective, only a handful of issuers have voluntarily included the Item 402(t) golden parachute compensation disclosures in their annual meeting proxy statements. Companies may be concerned with how these disclosures could impact the required Say-on-Pay vote, including whether such disclosures would be viewed favorably by proxy advisory services if the annual meeting proxies include the additional golden parachute compensation disclosures. In addition, companies may be concerned that providing such disclosures voluntarily signals the market that the company could be engaged in a significant transaction in the coming months.

Regardless of the frequency with which the exception is used by other companies, companies should consider voluntarily including the disclosure only if they foresee that including the disclosure will provide a longer term benefit to the company in the future, such as if there is a likely forthcoming transaction where the potential signaling effect is not a concern. In addition, companies with relatively simple golden parachute arrangements may find it beneficial to adhere to the Item 402(t) requirement as they would not be much more onerous to comply with these than the annual meeting proxy disclosures on change of control and termination arrangements required by Item 402(j) of Regulation S-K. In most cases, however, we would not recommend relying on the exception as it will likely provide little benefit to most issuers.

## **HOW ARE COMPANIES APPROACHING THE DISCLOSURE AND VOTE REQUIREMENTS?**

The new disclosure and vote requirements apply only to initial filings made on or after April 25, 2011. Even though it has been a relatively short period of time since the effectiveness of the new rules, there have been a couple of trends in the disclosures thus far.

For the most part, companies are adhering closely to the requirements of the new Golden Parachute Compensation Table in merger proxies, registration statements and other transactional forms. Because the rule itself explicitly describes the table and the accompanying narrative disclosure, much of the variation in the disclosure to date relates to the complexity of the arrangements, often manifested through the length and number of footnotes accompanying the Golden Parachute Compensation Table. In some cases, the new disclosure results in an additional page of disclosure in the applicable form or schedule, while in other cases the table and footnotes extend over several pages because of the complexity of various scenarios and triggering events.

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<sup>2</sup> Note that the exception does not provide for a separate advisory vote on golden parachutes in advance of a transaction. In order to take advantage of the exception, a company must include the new golden parachute compensation disclosure in an annual meeting proxy statement when the company is conducting a "Say-on-Pay" vote.

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In addition, many companies that have filed merger proxies or registration statements on Form S-4 that also require a shareholder advisory vote on golden parachutes have found it helpful to describe the relationship of the golden parachute advisory vote to other votes on the transaction, including approval of the deal itself. While companies are required to disclose that the golden parachute vote is non-binding, many have also disclosed whether or not the golden parachute vote is a condition of the transaction and whether the results of the advisory vote on golden parachutes would affect the consummation of the merger. As expected, generally approval of the golden parachute arrangements is not a condition of the transaction, and a lack of approval of the golden parachutes will not affect consummation of the transaction.

Many companies have also included disclosure regarding the effect of the golden parachute advisory vote on the status of the golden parachute payments. This type of disclosure typically notes that the golden parachute arrangements are contractual obligations of the company, and that even though the company values the input of shareholders as to whether such arrangements are appropriate, the company would nonetheless be required contractually to make, and would make, such payments even if the arrangements are not approved by the shareholders in the advisory vote.

We recommend that companies consider some of these additional clarifying disclosures so as to provide better context for the shareholders when they are considering their advisory vote on the golden parachute arrangements.

## **PRACTICAL ISSUES**

We also wanted to make note of some practical and interpretive issues to keep in mind while preparing a schedule or form with the new golden parachute compensation requirements.

### **Advance Planning**

Companies should consider the impact of the requirements before they sit down to draft the disclosures. In other words, it may be helpful for companies to move discussions of golden parachute arrangements and the required disclosure to an early point in the process so that the drafting of potentially complex disclosure is not left until the last minute. It may also be helpful to discuss the optics of the arrangements and, in transactions where an advisory vote is required, how shareholders are likely to react to the disclosure. This will help prevent surprises down the road.

### **Location of Disclosure**

Even though the various forms and schedules have been amended to require the disclosure of golden parachute arrangements, companies still have some leeway as to how the table will be presented and where in the document it will be included. For example, even if the golden parachute disclosure is required under a specific item of the form or schedule, it may make sense to include the table and accompanying narrative disclosure elsewhere in the document if there is, for example, additional executive compensation disclosure. Companies that choose to do this should include appropriate cross-references so that the disclosure is easy to locate.

In the examples we have seen thus far, some companies conducting a required shareholder advisory vote on golden parachute arrangements include the discussion of the vote with the Golden Parachute Compensation Table, while others discuss all the shareholder votes together and provide a reference to another part of the document where the table is located. Neither way is necessarily better, but companies should take care to make it clear what disclosure is covered by the shareholder advisory vote.

### **Disclosure of Voting Results**

While it is too early to gauge how issuers will present the results of the shareholder advisory vote on golden parachutes, we foresee that such results will simply be presented in an Item 5.07 Form 8-K together with the results of other shareholder votes which occur at the meeting. Companies may wish to consider some additional disclosure in the event

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they receive a high number of disapproval votes or more disapproval votes than approval votes. In most cases, though, the best course of action may be to simply present the results of the vote no matter the result, as there is no requirement to explain or comment upon the results. The acquiring company may also consider including disclosure in its future filings that would address the issue and discuss any changes to the compensation arrangements since the completion of the transaction.

### Contact:

**Michael G. O'Bryan**

(415) 268-6352

[mobryan@mofo.com](mailto:mobryan@mofo.com)

**David M. Lynn**

(202) 887-1563

[dlynn@mofo.com](mailto:dlynn@mofo.com)

**Scott G. Hodgdon**

(703) 760-7753

[shodgdon@mofo.com](mailto:shodgdon@mofo.com)

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