Wilson Sonsini Goodrich & Rosati
PROFESSIONAL CORPORATION

WSGR ALERT

JANUARY 2011

SEC ADOPTS FINAL RULES FOR SAY-ON-PAY, SAY-WHEN-ON-PAY, AND GOLDEN PARACHUTE ARRANGEMENTS

On January 25, 2011, the Securities and Exchange Commission (SEC) adopted amendments to its rules under the Securities Exchange Act to implement Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) relating to shareholder approval of executive compensation and "golden parachute" compensation arrangements. The final rules are available at http://www.sec.gov/rules/final/2011/33-9178.pdf.

Introduction

The Dodd-Frank Act amends the Securities Exchange Act by adding a new Section 14A. Section 14A(a)(1) requires that, not less frequently than once every three years, a company's proxy statement for an annual or other meeting of shareholders for which SEC rules require compensation disclosure must include a separate resolution subject to a non-binding shareholder vote to approve the compensation of named executive officers. This advisory vote on executive compensation is generally referred to as "say-on-pay."

Section 14A(a)(2) requires that a company's proxy statement include, not less frequently than once every six years, a separate resolution subject to a non-binding shareholder vote to determine whether the say-on-pay vote required by Section 14A(a)(1) will occur every one, two, or three years. This advisory vote is generally referred to as "say-when-on-pay."

Section 14A(b)(1) requires that, in any proxy or consent soliciting material for a meeting of shareholders to approve an acquisition, merger, consolidation, or proposed disposition of all or substantially all assets of an issuer, the soliciting person must include clear and simple disclosure of any agreements or understandings the soliciting person has with named executive officers of the issuer (or of the acquiror, if the soliciting person is not the acquiror) concerning any compensation that is based on or otherwise relates to the transaction (i.e., "golden parachute" arrangements). Under Section 14A(b)(2), unless these compensation arrangements previously have been subject to a say-on-pay vote, a separate non-binding shareholder vote to approve the golden parachute compensation arrangements will be required in connection with the business combination transaction.

Effective Dates

The say-on-pay and say-when-on-pay votes are required for companies' first annual or other meeting of shareholders occurring on or after January 21, 2011. The golden parachute arrangements disclosure requirements and shareholder vote will be required for specified merger-related filings made on or after April 25, 2011. Smaller reporting companies (generally those with a public float of less than $75 million as of the last day of their most recently completed second fiscal quarter) will not be required to conduct a say-on-pay vote or a say-when-on-pay vote until meetings held on or after January 21, 2013. This is a key difference between the proposed say-on-pay rules and the final rules adopted this week. However, there is no similar delay for smaller reporting companies with respect to the shareholder advisory vote on golden parachute compensation.

Say-on-Pay

Under new Rule 14a-21(a), issuers are required, not less frequently than once every three calendar years, to provide a separate shareholder advisory vote in proxy statements to approve the compensation of their named executive officers. While the rule does not require issuers to use any specific language or form of resolution to be voted on by shareholders, the shareholder advisory vote must be to approve the compensation of executives, as disclosed pursuant to Item 402 of Regulation S-K. A non-exclusive example of a resolution that would satisfy the applicable requirements is as follows:

> "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."

For smaller reporting companies, which are not required to include Compensation

Continued on page 2...

Discussion and Analysis (CD&A) disclosure in their proxy statement, the shareholder vote, when required in 2013, would cover the scaled disclosures required for such companies under Item 402.

Issuers are not limited to the required shareholder advisory vote under Rule 14a-21(a) and may solicit shareholder votes on a range of compensation matters to obtain more specific feedback on the issuer's compensation policies and programs if they wish.

The SEC also adopted amendments to the disclosure requirements of Item 402(b)(1) to require issuers to address in the CD&A whether, and if so, how, their compensation policies and decisions have taken into account the results of the most recent shareholder advisory vote on executive compensation. While smaller reporting companies would not be subject to such a specific disclosure requirement, they are already required to provide a narrative description of material factors necessary to understand the summary compensation table, and therefore would need to include disclosure of the impact of prior say-on-pay votes if this is a material factor in setting compensation.

The SEC confirmed that the shareholder vote on say-on-pay would not need to cover: (1) the compensation paid to directors; and (2) any disclosure pursuant to Item 402(s) of Reg. S-K about the issuer's compensation policies and practices as they relate to risk management, unless the risk considerations are a material aspect of the issuer's compensation policies or decisions for named executive officers.

Say-When-on-Pay

Under new Rule 14a-21(b), issuers are required, not less frequently than once every six calendar years, to provide a separate shareholder advisory vote in proxy statements for annual meetings to determine whether the say-on-pay vote will occur every one, two, or three years. Issuers are also required to provide disclosure in their proxy materials of the current frequency of say-on-pay votes and when the next scheduled say-on-pay vote will occur.

Shareholders must be given four choices: voting for the say-on-pay vote to occur every one, two, or three years, or abstaining from voting on the matter. While the issuer's board of directors may include a recommendation as to how shareholders should vote on the frequency of the say-on-pay vote, the issuer must make clear that the shareholders are not voting to approve or disapprove the issuer's recommendation. The proxy card must allow shareholders to vote for one of the four choices.

Under a new note to Rule 14a-8(i)(10), if, in the most recent say-when-on-pay vote, a single frequency (i.e., one, two, or three years) received the support of a majority of the votes cast (as compared to a plurality vote, as had been proposed), and the issuer has adopted a policy on the frequency of say-on-pay votes that is consistent with that choice, then the issuer may exclude a shareholder proposal that seeks a say-on-pay vote or relates to a say-when-on-pay vote. This means that companies may continue to be subject to shareholder proposals regarding say-on-pay unless their say-when-on-pay vote achieves majority-level approval and they adopt the frequency supported by the majority vote.

The SEC is also amending Item 5.07 of Form 8-K to require an issuer, following each say-when-on-pay vote, to disclose its decision regarding how frequently it will conduct a say-on-pay vote. To comply, an issuer will need to file an amendment to its prior Form 8-K filing under Item 5.07 that disclosed the results of the say-when-on-pay vote. The amended Form 8-K will be due no later than 150 calendar days after the date of the annual or other meeting in which the say-when-on-pay vote took place, but in no event later than 60 calendar days prior to the deadline for the submission of shareholder proposals under Rule 14a-8 for the subsequent annual meeting, as disclosed in the issuer's proxy materials for the meeting in which the say-when-on-pay vote occurred. The SEC had proposed putting such disclosures in a Form 10-Q or Form 10-K.

Disclosure and Shareholder Approval of Golden Parachute Arrangements

The SEC adopted Item 402(t) of Regulation S-K, which requires disclosure of named executive officers' golden parachute arrangements in both tabular and narrative formats. The table should present, in a series of columns for each named executive officer, the dollar value of all golden parachute payments potentially payable in connection with the transaction. Such disclosure is required for agreements or understandings between the named executive officer and either the acquiring company or the target company. The table should include columns for the dollar value of: cash severance; equity awards that are accelerated or otherwise cashed out; pension/non-qualified deferred compensation enhancements; perquisites and other personal and health and welfare benefits; tax reimbursements; other compensation; and the total amount of all such compensation, as shown on the table on following page:

Continued on page 3...

Continued from page 2...

Golden Parachute Compensation

Name	Cash ($)	Equity ($)	Pension / NQDC ($)	Perquisites / Benefits ($)	Tax Reimbursement ($)	Other ($)	Total ($)
Principal Executive Officer							
Principal Financial Officer							
Executive Officer A							
Executive Officer B							
Executive Officer C							

Each individual element of compensation is required to be quantified separately in footnote disclosure; for example, base salary, bonus, and non-equity long-term incentive plan compensation components of the aggregate cash amount should all be listed in a footnote. In addition, footnote disclosure is required to identify which amounts are attributable to "single trigger" arrangements and which are attributable to "double trigger" arrangements. The narrative disclosure requirement of Item 402(t), which requires disclosure of any material conditions or obligations applicable to the receipt of golden parachute payments (such as a non-compete or non-solicit obligation), is modeled on the narrative disclosure currently required under Item 402(j) relating to termination payments. However, note that Item 402(t) does not permit exclusion of *de minimis* perquisites and other personal benefits.

As proposed, the SEC amended the disclosure requirements of SEC forms other than proxy statements to require golden parachute payment disclosure in other business combination transactions, such as tender offers, going-private transactions, or transactions involving an information statement not subject to Regulation 14A, although the SEC exempted bidders in third-party tender offers from these disclosure requirements.

Section 14A(b)(2) of the Exchange Act requires a separate advisory shareholder vote on golden parachute arrangements required to be disclosed under Section 14A(b)(1). Under new Rule 14a-21(c), issuers are not required to provide a separate advisory vote in proxy statements for meetings of shareholders to approve a business combination transaction, if disclosure of the golden parachute compensation has been included in compensation disclosures that were the subject of a prior say-on-pay vote (regardless of the outcome of the vote). Rule 14a-21(c) clarifies that, in order to avail itself of this exception, the issuer must have included Item 402(t) disclosure in the executive compensation disclosure that was subject to a prior say-on-pay vote under proposed Rule 14a-21(a).

Typically, of course, change-in-control arrangements are not static. Their terms are subject to periodic revision, and there are often additional individuals who become eligible to receive change-in-control protections. Rule 14a-21(c) provides that, where the issuer has had a prior vote on compensation that included Item 402(t) compensation, only new arrangements and revised terms of arrangements previously subject to a say-on-pay vote under proposed Rule 14a-21(a) would be subject to the merger proxy statement separate shareholder vote. This would require two separate disclosure tables in the proxy statement, one for all change-in-control compensation arrangements, and one solely for the new or revised change-in-control arrangements.

Broker Discretionary Voting

Pursuant to Section 957 of the Dodd-Frank Act, the national securities exchanges are required to change their rules with regard to broker discretionary voting on certain matters, including executive compensation matters. Consequently, broker discretionary voting will not be permitted with regard to any of the advisory votes discussed above. The SEC noted in its final rules that the national

Continued on page 4...

securities exchanges have already made substantial progress in amending their rules to this effect.

Other Say-on-Pay Matters

The final rules add any shareholder advisory vote on executive compensation, including say-on-pay and say-when-on-pay votes, to the list of matters that do not require the filing of a preliminary proxy statement under Rule 14a-6(a). In addition, issuers with outstanding liabilities under TARP (who are subject to an existing separate annual say-on-pay requirement) will not be required to conduct an annual advisory vote on executive compensation under Section 14A.

Other Dodd-Frank Compensation Disclosure Matters

As disclosed in a previous WSGR Alert,[1] the SEC has published a planned timeline for the proposal and adoption of rules relating to the Dodd-Frank Act (available at http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml#0910). On January 26, 2011, the SEC extended its estimate of when it will propose rules for the following compensation disclosure matters required by Dodd-Frank from April-July 2011 to August-December 2011: pay-for-performance disclosure, CEO pay ratio disclosure, clawback policy disclosure, and hedging policy disclosure. Dodd-Frank did not impose deadlines for final rules to be adopted on these matters, and given the revised estimates provided and the time it takes to comment on and finalize rule proposals, there is a chance that these disclosure items may not be finalized in time for the 2012 proxy season.

What You Should Do Now

Say-on-pay and say-when-on-pay have been anticipated since the adoption of the Dodd-Frank Act over six months ago, and most companies are well on their way to preparing for these votes. There are still a number of things companies should do at this point, if they have not yet done so:

<u>Say-on-Pay</u>

- Review your company's pay practices, including prior and current year compensation amounts, and compare them to historic trends. Analyze how those compensation levels compare with company financial performance, and benchmark your company's compensation levels against a peer group of comparable companies.

- Review your previous proxy statement executive compensation disclosure, including CD&A, tabular, and narrative disclosure, to ensure clarity and transparency. While in the past executive compensation disclosure has been drafted to ensure compliance with the SEC's disclosure requirements, increasingly such disclosure will also need to be an advocacy piece for why shareholders should approve your compensation in the say-on-pay vote. In that regard, including an executive summary highlighting how your executive compensation corresponds with your company's financial results for the previous year, as well as improvements in compensation policies and practices, will become increasingly important.

- Determine what resources you will need to implement the say-on-pay and say-when-on-pay votes, including potentially: internal human resources, financial, investor relations, and legal staff; compensation consultant; outside counsel; and proxy solicitor.

- Develop an action plan to proactively address compensation practices and policies that need to be addressed with investors or that need to be revised, as well as how the say-on-pay and say-when-on-pay votes will need to interact with other proposals on your proxy statement, such as voting for a new or amended compensation plan or director elections.

- Look carefully at the definition of "smaller reporting company" in Rule 12b-2 and determine whether your company qualifies, allowing your company to take advantage of the two-year phase-in period for say-on-pay votes. The SEC recently released figures indicating that approximately half of all reporting companies qualify as smaller reporting companies.

<u>Say-When-on-Pay</u>

Evaluate what frequency of say-on-pay votes makes sense for your company, keeping in mind your shareholder base, peer group practice, ability to commit time to solicitation efforts, and likelihood of shareholder reaction. In that regard, we note the following:

- As of January 21, 2011, there were 153 companies that had filed proxy statements during this proxy season that

[1] This WSGR Alert is available at http://www.wsgr.com/WSGR/Display.aspx?SectionName=publications/PDFSearch/wsgralert_SEC_rulemaking_schedule.htm.

Continued on page 5...

Continued from page 4...

included say-when-on-pay proposals. Of these:

- 82 companies (54%) recommended a triennial vote;
- 47 companies (31%) recommended an annual vote;
- 13 companies (8%) recommended a biennial vote; and
- 11 companies (7%) made no recommendation.[2]

- By comparison, a recent Towers Watson poll of 135 public companies found that:
  - 51% expect to hold annual say-on-pay votes;
  - 39% prefer the vote be held every three years; and
  - 10% anticipate holding biennial votes.
- ISS is recommending an annual say-on-pay vote for all companies.
- In this year's first say-on-pay vote at an S&P 500 company, on January 25, 2011, over 62% of Monsanto's shareholders voted in favor of an annual vote, while only 36% voted with management's recommendation for a triennial vote. In response, Monsanto's board has already disclosed that it will implement an annual say-on-pay vote. If this vote is any indication, it may be very difficult for widely held companies with a primarily institutional shareholder base to get support for anything other than an annual say-on-pay vote.
- Boards of directors should strongly consider making a recommendation on the frequency of say-on-pay votes, as opposed to making no recommendation, and explaining their position lucidly in the proxy statement. Among other reasons, making a recommendation is important because it permits the proxy holders to vote uninstructed proxy cards in favor of management's recommendation.
- Use the proxy statement as an advocacy piece for why shareholders should vote for the frequency of say-on-pay votes recommended. Companies that propose to recommend a frequency other than an annual vote should allow additional drafting time in the proxy preparation process to craft persuasive proxy disclosure, and should allow additional time in the solicitation process to engage with shareholders on the frequency vote.

Say-on-Golden Parachutes

- We favor a case-by-case evaluation of the desirability of using the say-on-pay vote to pre-approve payment of future golden parachute arrangements at an annual meeting of shareholders, rather than needing to have such arrangements approved at the time of a business combination transaction. In our view, however, a company's primary focus should be on say-on-pay, and the enhanced disclosure required in proxy statements to describe golden parachute arrangements may be distracting, burdensome, or detrimental.

Shareholder Engagement Generally

- Review your shareholder composition generally to make sure you know answers to questions such as:
  - Do your major shareholders have internal voting guidelines, or do they follow proxy advisory firm voting guidelines?
  - What are their past voting practices, both with regard to your company specifically and in general?
  - Who is the decision maker on compensation issues?
- Develop a communications plan and team to engage with key shareholders on executive compensation and other corporate governance matters in connection with your annual meeting. As we have noted for several years, increased shareholder engagement will be crucial in the new era of corporate governance where majority voting is more common and say-on-pay is required of all public companies.

For any questions or more information on these or any related matters, please contact John Aguirre, Ralph Barry, Richard Cameron Blake, Warren de Wied, Katharine Martin, Ann Yvonne Walker, your regular Wilson Sonsini Goodrich & Rosati contact, or any member of the firm's corporate and securities or employee benefits and executive compensation practices.

---

[2] Source: Compensia, Inc.

Continued on page 6...

Continued from page 5...

Wilson Sonsini Goodrich & Rosati
PROFESSIONAL CORPORATION

This WSGR Alert was sent to our clients and interested parties via email on January 27, 2011. To receive future WSGR Alerts and newsletters via email, please contact Marketing at wsgr_resource@wsgr.com and ask to be added to our mailing list.

This communication is provided for your information only and is not intended to constitute professional advice as to any particular situation. We would be pleased to provide you with specific advice about particular situations, if desired. Do not hesitate to contact us.

650 Page Mill Road
Palo Alto, CA 94304-1050
Tel: (650) 493-9300 Fax: (650) 493-6811
email: wsgr_resource@wsgr.com

www.wsgr.com

© 2011 Wilson Sonsini Goodrich & Rosati,
Professional Corporation
All rights reserved.