

WSGR ALERT

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SECURITIES AND EXCHANGE COMMISSION ISSUES PROPOSED RULES RELATING TO SAY-ON-PAY, SAY-WHEN-ON-PAY, AND GOLDEN PARACHUTE ARRANGEMENTS

On October 18, 2010, the Securities and Exchange Commission (SEC) proposed amendments to its rules under the Securities Exchange Act that would implement the requirements of 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 proposed rules are available at <http://www.sec.gov/rules/proposed/2010/33-9153.pdf>.

Section 951 of the Dodd-Frank Act amended the Exchange Act by adding new Section 14A. Section 14A(a)(1) requires that, not less frequently than every 3 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 951 also added Section 14A(a)(2) to the Exchange Act, requiring that a company's proxy statement include, not less frequently than once every 6 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 1, 2, or 3 years. This advisory vote is generally referred to as "say-when-on-pay."

In addition, Section 951 added new Section 14A(b)(1) to the Exchange Act, requiring 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 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 also be required in connection with the business combination transaction.

The SEC's proposed rules provide important clarifications regarding the mechanics of the various voting requirements mandated by Section 951. Pursuant to Section 951, say-on-pay and say-when-on-pay votes are required for companies' first annual meetings on or after January 21, 2011, whether or not the SEC has adopted rules to implement the new requirements. Golden parachute arrangements need not be put to shareholder vote until after the SEC finalizes these proposed rules. However, Section 951

contains numerous ambiguities, and the SEC has attempted to address these ambiguities in its proposed rules.

Say-on-Pay

Proposed Rule 14a-21(a) would require an advisory shareholder vote on the compensation of named executive officers as disclosed in Item 402 of Reg. S-K, including the Compensation Discussion and Analysis (CD&A), the compensation tables, and other narrative disclosure required by Item 402. For 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), which are not required to include CD&A disclosure in their proxy statement, the shareholder vote would cover the scaled disclosures required for smaller reporting companies under Item 402.

The issuer would not be required to use a specific form of resolution, but the vote would be required to relate to all executive compensation disclosure pursuant to Item 402. Reg. S-K would also be amended to require issuers (other than smaller reporting companies) to address in CD&A whether—and if so, how—their compensation policies and decisions have taken into account the results of prior shareholder advisory votes on executive compensation. While smaller reporting companies would not be subject to

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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 also 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

Because Section 951 of the Dodd-Frank Act did not specify the manner in which issuers must present say-when-on-pay proposals to shareholders, there has been considerable speculation as to what approach the SEC would prescribe. Would issuers be permitted to offer shareholders a single choice (e.g., vote for, against, or abstain on say-on-pay every year), or would they be required to give investors a choice between having a say-on-pay vote every 1, 2, or 3 years?

In proposed Rule 14a-21(b) and the proposed amendments to Rule 14a-4 relating to the content of the form of proxy card, the SEC has taken a literal approach. Although the SEC expects that boards of directors will make a specific recommendation to shareholders in the proxy statement, the SEC would amend Rule 14a-4 to require the form of proxy card to present four choices to shareholders: whether the say-on-pay vote should occur every 1, 2, or 3 years, or whether to abstain. The SEC would also amend Forms 10-K and 10-Q to require companies to disclose, in the report

corresponding to the period in which the say-when-on-pay vote is taken, its decision regarding how frequently it would conduct shareholder advisory votes on executive compensation in light of the voting results.

The say-when-on-pay vote would be non-binding, but the SEC is proposing an incentive for issuers to adopt the alternative preferred by shareholders. Under a proposed amendment to the shareholder proposal rule, Rule 14a-8, pursuant to the "substantially implemented" exception, any shareholder proposal that would provide for a say-on-pay vote or say-when-on-pay vote, provided the issuer has adopted a policy on the frequency of say-on-pay votes that is consistent with the *plurality* of votes cast in the most recent say-when-on-pay vote.

Currently, major institutional investors are developing their internal guidelines regarding the frequency of say-on-pay votes. It appears that most of the major institutions favor an annual say-on-pay vote, although many have indicated a willingness to show flexibility on a case-by-case basis. It remains to be seen what policies Institutional Shareholder Services (ISS) will adopt regarding say-when-on-pay, as any new "withhold the vote" policy adopted by ISS would likely impact the ultimate response of issuers to the results of say-when-on-pay votes.

Disclosure of Golden Parachute Arrangements and Shareholder Approval of Golden Parachute Arrangements

Disclosure Requirements. The SEC is proposing to amend Schedule 14A to add specific disclosure requirements (to be set forth in new Item 402(t) of Reg. S-K) relating to golden parachute arrangements with named executive officers in connection with business combination transactions for which

shareholder approval is required under Regulation 14A. At the same time, although not required by the Dodd-Frank Act, the SEC proposes to amend the disclosure requirements of other SEC forms to require comparable disclosure in other business combination transactions, such as tender offers, going-private transactions, or transactions involving an information statement not subject to Regulation 14A.

The disclosure required by Section 14A(b)(1) of the Exchange Act is limited to agreements or understandings between the person conducting the solicitation and named executive officers of the issuer or any named executive officers of the acquiring issuer if the person conducting the solicitation is not the acquiring issuer. The person conducting the solicitation is typically the target company, not the acquiring company. However, because golden parachute arrangements may be entered into between the acquiring company and named executive officers of the target company, the SEC has formulated its new disclosure requirements to require disclosure of these arrangements (including arrangements with the acquiring company) in addition to the target company disclosures mandated by Section 14A(b)(1).

Proposed Item 402(t) would require both tabular and narrative disclosure. The table would 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. The table would 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 follows:

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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 would be 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 would all be listed in a footnote. In addition, footnote disclosure would be 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) is modeled on the narrative disclosure currently required under Item 402(j) relating to termination payments.

Proposed Item 402(t) is focused on change-in-control-related payments. Accordingly, certain amounts would not be required to be disclosed under Item 402(t), including existing pension benefits, vested equity awards, and compensation under bona fide post-transaction employment agreements.

Advisory Vote Requirement. 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). As noted above, the SEC has proposed to expand the disclosure requirements beyond those mandated by Section 14A(b)(1). However, the advisory vote requirement would not apply to arrangements for which the SEC is requiring disclosure but which are outside the scope of Section 14A(b)(1).

Under proposed Rule 14a-21(c), issuers would not be 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). Proposed 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. They are subject to periodic revision and new individuals receive change-in-control protections. Proposed 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

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not be permitted with regard to any of the advisory votes discussed above.

Other Matters

The SEC also proposes to add 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). The SEC indicates that, until the proposed rules are effective, it will not object to issuers not filing annual meeting proxy statements in preliminary form if the only matters that require a preliminary filing are say-on-pay and say-when-on-pay. Similarly, the SEC will not object to issuers utilizing the form of proxy card required for say-when-on-pay votes under Section 14A(a)(2) prior to the effective date of the new rules. In addition, if proxy service providers are unable to reprogram their systems to provide four separate choices on the form of proxy card in time for shareholder votes on say-when-on-pay, the SEC will allow forms of proxy cards to provide a choice between 1, 2, and 3 years so long as proxies are not voted if the holder does not select a choice. Finally, 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.

Comments

The proposing release contains 56 specific questions on which interested parties are invited to comment. Comments should be delivered to the SEC on or before November 18, 2010.

Next Steps

Compensation committees, boards of directors, and management should anticipate increased scrutiny of their executive compensation practices in the context of the new regime of say-on-pay and say-when-on-pay votes. With proxy access apparently on hold until the spring of 2011, compensation looms as the dominant issue on the corporate governance agenda for next year's annual meeting season. It is prudent for all public companies to re-assess their pay practices, identify issues that may give rise to concern, and take proactive steps to address any areas of concern. In addition, companies will be well served by taking time, well in advance of proxy season and SEC filing deadlines, to upgrade their CD&A and other executive compensation disclosures in order to present their programs and practices as clearly and cogently as possible.

For any questions or more information on these or any related matters, please contact

Warren de Wied, John Aguirre, Katharine Martin, Richard Cameron Blake, your regular Wilson Sonsini Goodrich & Rosati contact, or any member of the firm's corporate and securities or employee benefits and executive compensation practices.



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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

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