

Securities

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SEC Adopts Final Say-on-Pay Voting Rules

On January 25, by a 3-2 vote, the Securities and Exchange Commission adopted final rules requiring public companies to conduct separate shareholder advisory (nonbinding) votes on executive compensation and “golden parachute” compensation arrangements. These rules implement Section 14A of the Securities Exchange Act of 1934, enacted by the Dodd-Frank Wall Street Reform and Consumer Protection Act, and were adopted substantially as proposed on October 18, 2010, but with temporary relief for smaller reporting companies as discussed below.

The final rules impose four new requirements on public companies:

- Companies must conduct a separate shareholder advisory vote to approve the compensation of named executive officers (NEOs) as disclosed in annual or special meeting proxy statements for director elections (a “say-on-pay” vote). The say-on-pay vote must occur at least once every three years.
- Companies must conduct a separate shareholder advisory vote to determine whether the say-on-pay vote should occur every one, two or three years in annual or special meeting proxy statements for director elections (a “say-on-frequency” vote). The say-on-frequency vote must occur at least once every six years.
- Companies must conduct a separate shareholder advisory vote regarding golden parachute compensation arrangements in proxy statements for meetings to approve an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all of the assets of the company.
- Companies must disclose golden parachute compensation arrangements in connection with an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all of the assets of the company.

Rule 14a-6(a) has been amended to include say-on-pay and say-on-frequency votes among the items that do not trigger a preliminary proxy statement filing.

Click [here](#) for the Final Rule Release No. 33-9178.

Effective Dates

The Dodd-Frank Act requires public companies to conduct say-on-pay and say-on-frequency votes for their first annual or other such meeting of shareholders occurring on or after January 21, 2011, regardless of whether final rules had been adopted by the SEC. The final rules do not become effective until 60 days following publication in the Federal Register. Companies must comply with the new rules concerning the golden parachute vote and disclosure with respect to any merger proxy statement (and certain other similar filings) filed on or after April 25, 2011. The SEC also included a temporary exemption for smaller reporting companies (companies with public equity float of \$75 million or less) so

For more information, please contact your Katten Muchin Rosenman LLP attorney, or any of the following members of Katten’s [Corporate Practice](#):

Chicago

Matthew S. Brown
312.902.5207 / matthew.brown@kattenlaw.com

Michael J. Diver
312.902.5671 / michael.diver@kattenlaw.com

Adam R. Klein
312.902.5469 / adam.klein@kattenlaw.com

Lawrence D. Levin
312.902.5654 / lawrence.levin@kattenlaw.com

Jeffrey R. Patt
312.902.5604 / jeffrey.patt@kattenlaw.com

Herbert S. Wander
312.902.5267 / hwander@kattenlaw.com

Maryann A. Waryjas
312.902.5461 / maryann.waryjas@kattenlaw.com

Robert J. Wild
312.902.5567 / robert.wild@kattenlaw.com

Mark D. Wood
312.902.5493 / mark.wood@kattenlaw.com

Los Angeles

Mark A. Conley
310.788.4690 / mark.conley@kattenlaw.com

New York

Todd J. Emmerman
212.940.8873 / todd.emmerman@kattenlaw.com

Robert L. Kohl
212.940.6380 / robert.kohl@kattenlaw.com

David H. Landau
212.940.6608 / david.landau@kattenlaw.com

David A. Pentlow
212.940.6412 / david.pentlow@kattenlaw.com

Wayne A. Wald
212.940.8508 / wayne.wald@kattenlaw.com

Washington, D.C.

Jeffrey M. Werthan
202.625.3569 / jeff.werthan@kattenlaw.com

Frank Zarb
202.625.3613 / frank.zarb@kattenlaw.com

www.kattenlaw.com

that these issuers will not be required to conduct either a say-on-pay or say-on-frequency vote until the first annual or other meeting of shareholders occurring on or after January 21, 2013. This temporary exemption does not apply to shareholder advisory votes regarding golden parachute compensation of smaller reporting companies. Because companies that have received Troubled Asset Relief Program (TARP) funds are required by U.S. Treasury regulations to have an annual say-on-pay vote, which is effectively the same as the say-on-pay vote under these rules, TARP recipients are exempt from the requirement to include an additional say-on-pay vote and a say-on-frequency proposal until their first meeting at which directors are elected after the company is no longer subject to the TARP restrictions.

Say-on-Pay Shareholder Votes

Under the new Rule 14a-21(a) say-on-pay vote, shareholders vote to approve the compensation of the issuer's NEOs as such compensation is disclosed in the Compensation Discussion and Analysis (CD&A), the compensation tables, and other narrative executive compensation disclosures required by Item 402 of Regulation S-K. The compensation of directors, as well as the company's compensation policies and practices as they relate to risk management and risk-taking incentives regarding employee compensation generally, are not subject to the say-on-pay vote. While the final rule does not require issuers to use any specific language or form of resolution to be voted on by shareholders, the SEC included in an instruction to the rule the following as a non-exclusive example of a resolution that would satisfy the applicable requirements:

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.

As to smaller reporting companies, once the new rules apply following the temporary exemption, the final rules do not change the existing reduced executive compensation disclosure requirements, nor do they require inclusion of CD&A. However, the SEC notes in the final rule release that smaller reporting companies may wish to include supplemental NEO compensation disclosure to facilitate shareholder understanding of their NEO compensation arrangements in connection with say-on-pay votes.

Say-on-Frequency Shareholder Votes

Under the new Rule 14a-21(b) say-on-frequency vote, shareholders must choose whether the vote on executive compensation should occur every one, two or three years. Alternatively, they can abstain from voting on the matter. Companies must provide these four choices and only these four choices in a say-on-frequency vote. The SEC expects that the board of directors will include a recommendation as to how shareholders should vote on the say-on-frequency vote. A company may vote uninstructed proxy cards in accordance with management's recommendation for the say-on-frequency vote only if it complies with existing requirements of Rule 14a-4 to (1) include a vote recommendation in the proxy statement, (2) permit abstention on the proxy card, and (3) include language regarding how uninstructed shares will be voted in bold on the proxy card.

Effect on Shareholder Proposals

A new note to Rule 14a-8(i)(10) permits the exclusion of a shareholder proposal for a say-on-pay or say-on-frequency vote, provided the company has adopted a policy on the frequency of say-on-pay votes that is consistent with the majority, rather than a plurality, of votes cast in the most recent say-on-frequency vote. If there was not a majority vote on any vote frequency alternative, then the company will not be permitted to exclude a shareholder proposal for a different vote frequency.

Say-on-Golden Parachute Shareholder Votes

Under the new Rule 14a-21(c), companies are required for initial filings on or after April 25, 2011, to provide a separate shareholder advisory vote to approve golden parachute arrangements subject to enhanced disclosure under Item 402(t) of Regulation S-K (described below) in proxy statements for meetings at which shareholders are asked to approve an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all of the assets of the

company. Golden parachute arrangements refer to any agreements or understandings concerning any type of compensation (whether present, deferred or contingent) payable to a NEO that is based on or otherwise relates to the acquisition, merger, consolidation, sale or other disposition of all or substantially all of the assets of the company. While Item 402(t) requires disclosure of any golden parachute arrangements between the target company or the acquiring company and the NEOs of both companies that relate to the transaction, the say-on-golden parachute vote is required only to approve the golden parachute agreements or understandings between the issuer soliciting the proxies to approve the transaction and its NEOs. Therefore, where the target company is soliciting proxies from its shareholders to approve the transaction, the target's golden parachute arrangements with its NEOs would be subject to approval. Alternatively, if the acquiring company is soliciting proxies from its shareholders to approve the transaction, then the golden parachute arrangements with its NEOs are subject to the vote of the acquiring company's shareholders.

The new rule does not require companies to use any specific language or form of resolution to be voted on by shareholders, and the vote is not binding on the company or its board of directors.

Companies will not be required to include a separate shareholder vote on golden parachute compensation in the merger proxy statement if Item 402(t) disclosure of that compensation had been included in the executive compensation disclosure that was subject to a prior say-on-pay vote. For companies to take advantage of this exception, however, the executive compensation disclosure subject to the prior shareholder say-on-pay vote must have included Item 402(t) disclosure of the same golden parachute arrangements.

Additional Disclosure Regarding Golden Parachute Compensation

Amended Item 5 of Schedule 14A now requires additional public disclosure with respect to golden parachute compensation arrangements in proxy or consent solicitations in connection with an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all of the assets of the company. Item 402(t) of Regulation S-K requires disclosure of all golden parachute compensation relating to the merger among the target and acquiring companies and payable to the NEOs of each in order to cover the full scope of golden parachute compensation applicable to the transaction. This disclosure has a broader reach than the required shareholder advisory vote.

Item 402(t) requires disclosure of NEOs' golden parachute arrangements in both tabular and narrative formats. Such tabular and narrative disclosure is required only for compensation that is based on or otherwise relates to the transaction. This disclosure is not required in third-party bidders' tender offer statements, so long as the transactions are not also Rule 13e-3 going-private transactions.

The new narrative disclosure requirements require public companies to describe any material conditions or obligations applicable to the receipt of payment, including but not limited to non-compete, non-solicitation, non-disparagement, or confidentiality agreements, their duration, and provisions regarding waiver or breach. Such companies must also provide a description of the specific circumstances that would trigger payment, whether the payments would or could be lump sum or annual, the duration of the payments, by whom the payments would be provided, and any other material factors regarding each agreement.

The new amendments require such disclosure not only in a proxy or consent solicitation relating to such a transaction, but also in:

- information statements filed pursuant to Regulation 14C;
- 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 on Forms S-4 and F-4 containing disclosure relating to mergers and similar transactions;
- going private transactions on Schedule 13E-3; and
- third-party tender offers on Schedule TO and Schedule 14D-9 solicitation/recommendation statements.

Where a company previously included golden parachute compensation arrangements in a say-on-pay vote and such arrangements have been modified since the say-on-pay vote, companies providing for a shareholder vote on new arrangements or revised terms should provide two separate tables under Item 402(t) of Regulation S-K in merger proxy statements. One table should disclose all golden parachute compensation, including both arrangements and amounts previously disclosed and subject to a say-on-pay vote and the new arrangements or revised terms. The second table should disclose only the new arrangements or revised terms subject to the vote.

New Disclosures

Item 24 of Schedule 14A requires public companies to disclose that they are providing a separate shareholder vote on executive compensation and to briefly explain the general effect of the vote, such as whether the vote is non-binding. Such companies are also required to disclose the current frequency of say-on-pay votes and when the next say-on-pay vote will occur.

Item 402(b) of Regulation S-K now requires public companies (other than smaller reporting companies) 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.

The final rules amend Item 5.07 of Form 8-K to require the filing of an amendment to the Form 8-K that reported the final voting results from a meeting which included a say-on-frequency vote to disclose how frequently the company has decided to conduct say-on-pay votes in light of the results of its say-on-frequency vote. The Form 8-K/A is due no later than 150 calendar days after the date of the annual or other meeting in which the say-on-frequency vote took place, but in no event later than 60 calendar days prior to the deadline for the submission of shareholder proposals for the subsequent annual meeting as disclosed in the proxy statement for the meeting of shareholders at which the say-on-frequency vote occurred.

Compliance Considerations

Disclosure matters. Consider enhancing CD&A by including a brief executive summary that demonstrates pay for performance. Consider including a supporting statement in the say-on-pay proposal that makes a persuasive case for the company's executive compensation practices. Review pay practices identified as problematic by proxy advisory firms and either eliminate or provide disclosure that explains and justifies the subject practice in the context of the company's compensation structure. Consider the SEC example say-on-pay proposal when drafting, although the proposal can be phrased consistently with the style of other proposals and need not be in resolution format. Consider including a supporting statement in the say-on-frequency proposal, particularly if the company makes a biennial or triennial frequency recommendation.

Targeted shareholder engagement. In light of the Dodd-Frank Act-required amendments to NYSE Rule 452 to eliminate broker discretion to cast votes on executive compensation matters in the absence of client instructions and the potential effects on voting behavior of institutional money managers resulting from the new reporting of their votes beginning this summer, consider targeted outreach to enhance favorable voting on say-on-pay. Be mindful of investors' published voting policies on compensation and their reliance on proxy advisory firms' recommendations. Also, recognize the prevalence of statements regarding institutional investors' presumed preference for annual frequency in order to focus dialogue constructively on the say-on-pay vote rather than a potentially less well received position on biennial or triennial frequency. Consider retention of proxy solicitors to identify the largest shareholders and provide advice on engagement strategies.

Say-on-frequency vote recommendation. In order to vote uninstructed shares, consider a recommendation on frequency. If the company chooses to make a recommendation for biennial or triennial frequency, consider a supporting statement explaining the relationship of the vote frequency to the longer term goals and measurement of performance-based compensation. Compensation consultants have reported statistics on say-on-frequency recommendations in the over 150 proxy statements filed by January 21, 2011. Of the company recommendations, 82 were for a triennial vote, 47 for an annual vote, and 13 for a biennial vote; 11 made no recommendation. It will be important to monitor reported voting results of these meetings as the proxy season proceeds to get a sense of shareholders' preferences.

Proxy advisory firms' policies. In addition to considering the proxy advisory firms' policies on problematic pay practices as they relate to their say-on-pay recommendations, consider ISS's and Glass Lewis's announced policy favoring annual say-on-pay votes when making a say-on-frequency recommendation. Also consider that seeking approval of golden parachute arrangements at an annual meeting will result in ISS applying its golden parachute review guidelines when determining its recommendation on say-on-pay. This bundling may have the effect of a recommendation against a company's compensation arrangements, which would not have occurred in the absence of seeking approval of golden parachute arrangements.

Smaller reporting companies. We believe that smaller reporting companies will avail themselves of the temporary exemption from the say-on-pay and say-on-frequency votes and will not elect to voluntarily include these proposals. Of note is that recent SEC statistics reflect that approximately 4,350 issuers, or 48% of all Exchange Act reporting companies, have self identified as smaller reporting companies. For those companies that choose to include such proposals, persuasive supporting statements are even more important because smaller reporting companies are not required to include CD&A.

Proxy season checklists. Calendar the Form 8-K/A filing to report the company's determination as to frequency in years in which the say-on-frequency proposal was on the ballot. Calendar annual meeting for inclusion of the say-on-frequency proposal.

Katten

www.kattenlaw.com

Katten Muchin Rosenman LLP

CHARLOTTE

CHICAGO

IRVING

LONDON

LOS ANGELES

NEW YORK

WASHINGTON, DC

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