Fall 2012 | *Volume 3, Edition 2*

Perspectives

AN EXECUTIVE COMPENSATION, BENEFITS & HUMAN RESOURCES LAW UPDATE

pillsbury

QUESTIONS FROM OUR READERS...

Q. What issues will be heavily discussed in upcoming meetings of compensation committees for publicly traded companies?

A. Clawback, stock pledging and change-in-control policies are likely to be on the minds of many boards this upcoming year. Each issue fits a pattern that may seem quite familiar by now: actions items from the Dodd–Frank Act expanded upon by the shareholder proxy services.

New to the Institutional Shareholder Services' ("ISS") proxy guidance policy this year is a strict stance against stock hedging (i.e., utilizing instruments negatively correlated to stock price) and stock pledging (i.e., utilizing stock as loan collateral) by directors and executive officers. While Dodd–Frank section 955 merely contemplates a stock hedging disclosure regime, ISS favors prohibition of hedging. In addition, ISS may provide negative vote recommendations at companies with significant pledge commitments relative to shares outstanding and without any anti-pledging policies.

The SEC will likely release guidance on the Dodd–Frank section 954 financial restatement clawback in 2013. ISS scrutinizes board responses to all shareholder clawback proposals based on the company's history of financial controls issues and its current clawback policy. For boards that choose to preempt shareholder clawback proposals, arriving at the proper plan will require a thoughtful evaluation of the culture and incentive structure at the company.

ISS has also expanded its review of Dodd–Frank section 951 "say on golden parachute" votes. Whereas ISS only reviewed recently adopted or revised severance agreements during the 2012 proxy season, in 2013 all severance agreements will be analyzed, regardless of adoption date. Weighing against ISS approval of a golden parachute vote are the existence of any single and modified single-trigger cash severance payments, single-trigger acceleration of unvested equity and "excessive" golden parachutes.

The upcoming year is sure to be an interesting one. We wish you good health and great success in 2013!

IN THIS EDITION...

Year-end Deadline for Correcting Section 409A Deferred Compensation Arrangements That Condition Payment on an Employee Release or Covenant

by Peter J. Hunt and Matthew C. Ryan[1]

By December 31, 2012, all deferred compensation arrangements in which payment is contingent on employee action, such as execution of a release of claims, must either include payment-timing restrictions that comport to IRS Notice 2010-80 or satisfy an exemption from section 409A of the Internal Revenue Code (the "Code"). Employers should review all deferred compensation arrangements, especially employment agreements, severance agreements, and change-in-control agreements that require employees to execute a release of claims, non-compete covenant, or non-solicitation covenant.

Section 409A Restricts the Timing of Contingent Deferred Compensation Payments

When a payment is contingent on an employee release or covenant, the employee may be able to manipulate the payment's tax year by strategically timing his or her execution of the release or covenant. For deferred compensation arrangements suffering this weakness, IRS Notice 2010-80 provides a Code section 409A cure.[2] The arrangements must be amended to specify that all contingent payments will occur:

1. On a fixed date, either 60 or 90 days after the occurrence of the event triggering payment (e.g., separation from service); or
2. During a period not longer than 90 days after the occurrence of the event triggering payment, provided that if the specified period begins in one taxable year and ends in a second taxable year, the payment will always be made in the second taxable year.

Identifying and Correcting a Typical Violation

For example, assume an employment agreement provides for a lump sum severance payment subject to Code section 409A to be made within 90 days of separation, as long as the employee executes a general release of claims. If separation occurs on December 1st, 2012, then the employee can determine the tax year for that payment by choosing whether to deliver the executed release during either 2012 or 2013. This is a Code section 409A documentary failure. Even if an opportunity for tax year manipulation never arises, the employee could face a 20% penalty tax on the deferred sum.

One solution is to amend the employment agreement to specify that, if the 90-day payment period spans two calendar years, payment will always occur in the second year, regardless of when the release is executed. Alternatively, the agreement can be amended to specify that payment will occur on the 60th day (or 90th day) after separation, provided the employee has executed the release and the period for revoking the release has expired prior to the payment date. Either type of amendment would accommodate the 21-day consideration period[3] and 7-day revocation period prescribed by the Older Workers' Benefit Protection Act of 1990 for enforceable age discrimination waivers.

Year-end Deadline for Correcting Section 409A Deferred Compensation Arrangements That Condition Payment on an Employee Release or Covenant (continued)

Arrangements to Review for Section 409A Compliance

Code section 409A covers a range of nonqualified deferred compensation arrangements, ranging from group plans to individualized agreements.[4] Typical examples include:

- supplemental executive retirement plans;
- excess benefit plans;
- employment agreements;
- severance plans and individual severance agreements;
- phantom stock plans;
- restricted stock units;
- cash-settled equity awards;
- change-in-control agreements; and
- long-term bonus deferrals.

The final Code section 409A regulations issued by the IRS in 2007 did not identify contingent payment provisions as a plan failure. Accordingly, even deferred compensation arrangements previously subjected to a Code section 409A audit may require correction.

Section 409A Exempted Arrangements May Not Require Amendment

Many deferred compensation arrangements—especially bonus and severance plans—can avoid Code section 409A restrictions by satisfying either the exemption for "short-term deferrals" or the exemption for separation pay following an involuntary separation from service.

The short-term deferral exemption is available if payment will occur on or before the March 15th that follows the year in which the employee's right to the deferred compensation is no longer subject to a significant risk of forfeiture.[5] The separation payment exemption is available if the severance will be paid on or before the end of the second calendar year after the year in which an involuntary termination occurs and the severance does not exceed two times the lesser of the employee's annual rate of pay or the qualified plan compensation limit ($250,000 for 2012).

In order to satisfy either of these exemptions, however, the documentation must be clear that payment will made before the applicable exemption's deadline. If a deferred compensation arrangement conditions payment on the employee's signing of a release or a covenant, and the employee can use that condition to delay payment beyond the deadline required by the exemption (this is especially a risk with the short-term deferral exemption), then the employer should amend the documentation to include a payment deadline that is compliant with the applicable Code section 409A exemption.

Taking Advantage of the Transitional Relief Program

The transitional relief offered until December 31, 2012 includes three requirements. First, the employer must use commercially reasonable efforts to identify all deferred compensation arrangements subject to Code section 409A that include employee action-contingent payments. Second, the employer must correct such arrangements to include the payment-timing restrictions provided in IRS Notice 2010-80. Third, the employer must notify the IRS of all corrections made via a statement attached to its federal income tax return.[6] If corrections are made before the end of this year, then Code section 409A's tax penalties may be entirely avoided and the affected employees will not need to provide any notice to the IRS of the corrections made.

Year-end Deadline for Correcting Section 409A Deferred Compensation Arrangements That Condition Payment on an Employee Release or Covenant (continued)

If you have any questions about the content of this publication, please contact the Pillsbury attorney with whom you regularly work or the Executive Compensation & Benefits group.

[1] Law clerk awaiting admission to the bar.

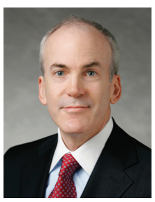
[2] This corrective program was first discussed in our December 20, 2010 Client Alert, IRS Relaxes Rules on Fixing Release-Contingent Payments in Non-qualified Deferred Compensation Plans.

[3] Note that a 45-day consideration period applies if the release of claims is requested in connection with a group or class termination.

[4] Code section 409A requirements do not apply to retirement plans qualified pursuant to Code section 401(a), tax deferred annuity plans authorized under Code section 403(b), and eligible deferred compensation plans authorized under Code section 457(b).

[5] For employers with a non-calendar fiscal year, the payment deadline may be extended until 2 ½ months after the end of the employer's fiscal year.

[6] Notice to the IRS must include names and taxpayer identification numbers for all affected employees, identification of the affected deferred compensation arrangements, citation to the IRS notice prescribing the utilized corrective measure, date of correction, and amount involved in the correction.



Peter J. Hunt is a partner in the New York office. He can be reached at 212.858.1139 or peter.hunt@pillsburylaw.com

Human Resources Considerations in Spinoffs

By Scott E. Landau and Bradley A. Benedict

The spinoff of a division, unit or business line from an existing company ("Parent") into an independent entity ("NewCo") presents numerous challenges for human resources ("HR") management. Spinoffs can be uniquely demanding on an organization as they involve strategic, organizational and legal planning for two entities. When a global organization splits off a business division across national jurisdictions with differing legal regimes, the complexities are multiplied. In any case, effective HR management, planning and implementation throughout the process can facilitate a successful spinoff. This Advisory highlights important HR-related considerations in the context of a spinoff, focusing on contractual issues, regulatory compliance and other legal matters.

Allocation of Personnel

A fundamental decision in any spinoff is the population of Parent employees who are intended to transfer to NewCo. Making this determination early can facilitate HR planning for the transition and post-restructuring periods. Related matters include:

"Ring-fencing"

Parent and NewCo may consider a post—spinoff no—hire agreement that prohibits each party from poaching employees assigned to the other for a period of time to reinforce the agreed-upon employee allocation. This can be done in conjunction with establishing policies barring certain employees from seeking such employment opportunities during the restricted period.

Internal services

It is critical to identify what services may no longer be available to each entity after the reorganization due to the division of the workforce. For example, if the entire internal accounting department stays with Parent, then NewCo will need to replace those services. In addition to personnel gaps, there may be systems that NewCo will need to procure (HRIS, performance management, etc.) to continue business as usual. In this regard, HR management must consider its role as a provider of HR services to the organizations as well as a consumer of internally provided services. Such needs may be filled over the short term under a Transition Services Agreement ("TSA") where one entity agrees to continue to provide services to the other for a transition period. TSAs should be as specific as practicable as to the required services, the individuals who will provide them and the amount of time they will dedicate, the duration of the transition period and the cost allocation or payment. Drafting effective TSAs is challenging due to the difficulty of anticipating such details, especially where the spun-off business unit is deeply integrated into Parent's infrastructure. Nevertheless, a comprehensive and detailed TSA can be invaluable when disputes arise, as they often do when individuals struggle to "serve two masters" whose interests may no longer be aligned.

Employee retention

Retention issues can be a major factor in spinoffs. Disruption to the status quo can lead individuals to consider other opportunities, particularly if there is uncertainty surrounding post-spinoff compensation packages, reporting lines, relocation and other potential employment-related changes. Part of a retention strategy may include putting incentive retention agreements in place for key management personnel and implementing an effective communications strategy to alleviate anxiety about employees' future roles and build buy-in for the restructuring.

New employer context

Human Resources Considerations in Spinoffs (continued)

In some cases, the employee allocation may have significant effects on the nature of Parent or NewCo. For example, a substantial change in the size or other characteristics of the workforce (e.g., union versus non-union, geographic location) or corporate organization (e.g., public versus private company) can significantly alter the employment context. Such changes may present HR management with opportunities for improving compensation and employee benefit structuring.

Compensation and Employee Benefits

Two main questions for HR leaders in any spinoff are: what effect will the spinoff have on existing compensation and benefits, and how will compensation and benefits be structured post-spinoff. A determination needs to be made whether the contemplated arrangements are consistent with existing contractual obligations or if modifications are required. Understanding the legal and tax implications of the proposed arrangements is also important, as these may differ in the context of a new or newly reorganized employing entity. All of these issues need to be explored for each applicable jurisdiction for international spinoffs. In this regard, an employer will be considerably more restricted in its ability to make unilateral changes to employee compensation and benefits, and other terms of employment, in certain non-U.S. jurisdictions.

Effect on Parent plans

Issues relating to Parent's existing compensation and benefit plans include:

- Are amendments required for Parent's severance plan (or its contractual severance arrangements) to prevent benefits from being triggered by employment transfers to NewCo?
- Will such transfers be considered terminations of employment under Parent's retirement, deferred compensation and other employee benefit plans?
- What happens to transferring employees' outstanding awards under any equity-based compensation plans sponsored by Parent—will awards be retained, cashed out, forfeited or substituted with rights under a NewCo plan?
- Will there be any acceleration of unvested stock-based benefits?
- If there are incentive stock options outstanding, can their tax-advantaged status be preserved?

NewCo plans

Spun off companies often must establish a slate of new employee benefit plans. Many companies mirror the parent's benefit plans and programs in a "clone and go" approach, but this may not always be feasible, cost-effective or desirable. For example, a self-funded medical plan may not be appropriate if NewCo's workforce is substantially smaller than Parent's. Or bonus programs may need to be redesigned to use incentives that work under the new business model and the most advantageous form and timing of payments given the entity's financial condition and capitalization structure post-spinoff. It should be noted that implementing new equity incentive plans can be a complex process, particularly for cross-border plans having participants in multiple countries. For Parent's funded benefit plans, such as 401(k) plans and defined-benefit pension plans, a plan spinoff or plan-to-plan transfer may be considered, where the assets and liabilities relating to transferring employees are transferred to a NewCo plan.

Determinations will need to be made concerning the preservation of benefits under NewCo's plans, such as the extent to which NewCo employees will be credited for their service with Parent and whether the applicable NewCo welfare plans will waive preexisting condition and waiting period restrictions or credit out-of-pocket expenses incurred under Parent's plans in the plan year of the spinoff toward the deductibles and co-payment thresholds under the corresponding NewCo plans.

Third-Party HR Service Providers

NewCo will need to negotiate and put in place new agreements with HR service providers, such as payroll processors, benefit plan administrators, employee leasing and temporary services agencies, and others. This can be an opportunity for NewCo to shop for new vendors and/or negotiate more favorable terms with current ones (e.g., with respect to pricing, payment schedules, indemnification clauses, etc.). Whereas Parent will need to determine if the change in its workforce will affect any of the terms under its service provider agreements.

Certain service providers will be expected to assist in the spinoff transition and will be integral to HR's ability to fully function on Day One. Providing early notice to the concerned parties and establishing clear action plans and realistic timelines are key to successfully managing this process.

Allocation of Employment Liabilities

The documents governing the spinoff should explicitly allocate responsibility for all employment-related obligations, whether they arise before, on or after the spinoff. These include liabilities arising from employment-related litigation (e.g., for discrimination or harassment), unfunded benefit plan liabilities such as retiree health and life insurance benefits, disability obligations, deferred compensation, welfare plan and workers' compensation "runoff claims" (i.e., claims incurred prior to the spinoff date but made afterward), COBRA continuation benefit obligations, and other unfunded obligations to employees accrued through the spinoff date, such as unpaid bonus and commission compensation and vacation time. Such liabilities also include restructuring-related obligations such as retention bonuses.

Union and Works Council Matters

If any of the affected employees (which may include employees staying behind with Parent or transferring employment to NewCo) are covered under a collective agreement with a union, works council or other employee association, Parent will need to fulfill any notification requirements and, if applicable, consultation and/or consent requirements. Parent should commence this process sufficiently in advance so that any required consultation does not disrupt the timing of the spinoff.

Communications

Explaining the employer's goals to the affected workforce, informing individuals about what is expected from them and what they can expect in return, and generally providing updates as developments arise can bolster morale during a time of uncertainty, reduce attrition rates and improve buy-in. In some cases, there are legal aspects to consider as well. In addition to any union or works council notice, advisory or consultation requirements, such obligations may also arise under European laws implementing the Acquired Rights Directive and similar laws outside the United States when there is a transfer of employment. These requirements should be identified in the early planning stages so that they may be satisfied in a timely manner without affecting the timing of the transaction.

Onboarding, Governmental Filings, Data Privacy and Other Legal Compliance

Legal compliance issues that arise in connection with employment transfers and onboarding vary greatly depending on the applicable jurisdictions. Routine matters may include filing with the appropriate governmental agencies for tax collection and social insurance and handling any visa issues if international employees are affected. In some jurisdictions, structuring employment transfers may require particular documentation to preserve "continuous employment" treatment, which may be necessary to avoid triggering statutory notice and/or severance payment obligations. Data privacy laws regulating the collection and transfer of employee related data are another key compliance area. In the United States, the main issues to be aware of concern "personal health information" protection under HIPAA and the security of certain sensitive data such as Social Security Numbers. The European Union's Data Protection Act and legislation in other countries (including Australia, Canada, Mexico and Malaysia, among others) set forth comprehensive data privacy schemes. In the context of a

Human Resources Considerations in Spinoffs (continued)

spinoff, these laws may require certain measures to be taken to allow for cross-border transfer of such information, such as obtaining employee consent.

HR leadership plays a central role in many aspects of spinoffs: workforce planning, employee communications, ensuring NewCo's payroll and other HR services and employee benefit plans are ready on Day One and avoiding personnel-related disruptions to business operations, among many others. Focusing on legal compliance matters starting from the early planning stages and continuing throughout the transition can help avoid unpleasant surprises and costly delays and contribute to a successful new beginning for both Parent and NewCo going forward.

If you have any questions about the content of this advisory, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

Scott E. Landau is a partner in the New York office. He can be reached at 212.858.1598 or scott.landau@pillsburylaw.com

Bradley A. Benedict is an associate in the New York office. He can be reached at 212.858.1523 or bradley.benedict@pillsburylaw.com

Plaintiffs' Firms Gaining Steam in New Wave of Say-on-Pay Shareholder Suits?

By Sarah A. Good, Cindy V. Schlaefer, and Ana N. Damonte

Over two years ago, Congress enacted Section 951 of the Dodd–Frank Act, which requires public companies to conduct an advisory shareholder vote on the company's executive compensation plan—the so-called "say-on-pay vote." Immediately after its enactment, plaintiffs' firms began filing shareholder actions against directors, executive officers, and compensation consultants of companies that failed to obtain a majority shareholder vote in favor of their plans. With a growing number of courts dismissing such suits, plaintiffs' firms have orchestrated a new strategy to hold companies liable: suits to enjoin the shareholder vote because the proxy statement fails to provide adequate disclosure concerning executive compensation proposals. Such suits have met with some success—with two court orders enjoining shareholder meetings and five settlements prior to companies' annual meetings.

The Say-on-Pay Statute

Congress enacted the Dodd–Frank Wall Street Reform and Consumer Protection Act on July 21, 2010 ("Dodd–Frank Act"). Section 951 of the Dodd–Frank Act amends the Securities Exchange Act of 1934 ("Exchange Act") by adding Section 14A ("Say-on-Pay Statute"), which requires public companies: (1) to conduct a separate shareholder advisory vote to approve the compensation of executives, (2) to conduct a separate shareholder advisory vote to determine how often an issuer will conduct a shareholder advisory vote on executive compensation, and (3) when soliciting votes to approve merger or acquisition transactions, to provide disclosure of certain golden parachute compensation arrangements and, in certain circumstances, to conduct a separate shareholder advisory vote to approve those arrangements. On January 25, 2011, the Securities and Exchange Commission adopted rules implementing Section 951 of the Dodd–Frank Act, which became effective on April 4, 2011.

The Onslaught of Shareholder Derivative Actions Following the Dodd–Frank Act.

Immediately after passage of Section 951, plaintiffs' firms began filing shareholder actions against directors, executive officers, and compensation consultants of companies where a majority of the shareholders voted against approval of recommended executive compensation—so called, failed "say-on-pay votes." The suits included: (1) claims against directors and executive officers for breach of fiduciary duty and violation of Section 14(a) of the Exchange Act, (2) claims against compensation consultants for aiding and abetting breach of fiduciary duty and breach of contract for failure to render competent and sound advice regarding executive compensation, and (3) claims against executive officers for unjust enrichment. The allegations of misconduct in these suits were similar—the defendants recommended purportedly excessive executive compensation: (1) at a time when the company's financial performance was dismal, (2) that violated the company's pay-for-performance compensation policy, and (3) that was not in the best interests of shareholders, as evidenced by the failed say-on-pay advisory vote.

In 2010, shareholders filed suits against the directors and officers of two of the first companies with failed say-on-pay shareholder votes. Both of these cases subsequently settled with attorneys' fees awards ranging between $1.0-1.75 million.

Emboldened by the foregoing results, in 2011, plaintiffs' firms piled on. In 2011, the shareholders of 43 public companies voted against the approval of executive compensation proposals at annual shareholder meetings. Plaintiffs' firms sued directors, officers, and/or compensation consultants of at least 15 of those companies—comprising 35% of all companies

Plaintiffs' Firms Gaining Steam in New Wave of Say-on-Pay (continued)

with failed say-on-pay shareholder votes. 87% of those suits were filed prior to September 2011—the month in which the first court decision was issued granting defendants' motion to dismiss. See *Teamsters Local 237 Additional Security Benefit Fund v. McCarthy (Beazer Homes USA, Inc.),* Case No. 2011cv197841 (Ga. Sup. Ct. 2011).

To date, 10 of the 15 suits or 67% resulted in defendants' motions to dismiss being granted —two of which are currently on appeal and one of which is pending the filing of an amended complaint. Of the remaining 5 suits, only one court denied defendants' motion to dismiss—*NECA-IBEW Pension Fund v. Cox (Cincinnati Bell),* Case No. 1:11-cv-00451 (S.D. Ohio 2011—and the parties subsequently settled). A second case—pending in the U.S. District Court in Delaware—settled prior to the court's decision on defendants' motion to dismiss and included payment of $1.1 million in attorneys' fees and expenses to plaintiffs' counsel The remaining three cases have motions to dismiss pending.

With a growing trend of courts dismissing failed say-on-pay suits, in 2012, shareholders filed suits against directors and officers concerning say-on-pay votes at only five companies—four companies with failed say-on-pay votes and one company for allegedly providing false and misleading statements in a proxy statement that resulted in a favorable say-on-pay shareholder vote. In addition, the two plaintiffs' firms leading the charge in 2010 and 2011 ceased filing such suits. Presumably, those law firms decided to cut their losses when their strategy did not yield anticipated returns on their investment of resources. Four of these 2012 cases remain pending and one was dismissed by the court pursuant to a motion to dismiss.

The courts that granted defendants' motions to dismiss in failed say-on-pay vote cases provided one or more of the following bases for their decisions:

- Failure of Demand Futility. The courts held that plaintiffs were not excused from making a litigation demand on the board of directors. Plaintiffs failed to adequately allege demand futility because the court found that a majority of the directors were disinterested and independent, and the complaint failed to allege any particularized facts suggesting that the decision was not made on an informed basis or providing any doubt that the decision was made in good faith and in the directors' honest belief that it was in the company's best interest.
- The Say-on-Pay Statute. The Say-on-Pay Statute specifically states that the shareholder vote is merely advisory and non-binding. It also states that shareholder votes do not "create or imply any change to the fiduciary duties of such issuer or board of directors" nor do they "create or imply any additional fiduciary duties for such issuer or board of directors."
- Timing of Shareholder Vote. The shareholder vote does not rebut the business judgment rule of the directors' decision regarding executive compensation because the shareholder vote occurred after the directors already made their decision. The directors did not have the result of the shareholder vote at the time they made their decision concerning executive compensation.
- Evidentiary Weight of Shareholder Vote. One court, however, noted that "a shareholder vote on executive compensation has substantial evidentiary weight and may be used as evidence by a court in determining whether" the presumption of the business judgment rule is rebutted; however, the "shareholder vote alone is not enough to rebut the presumption of the business judgment rule." *Laborer's Local v. Intersil,* Case No. 11-cv-04093 (N.D. Cal. 2011) (granting motion to dismiss).

The Recent Trend: Putative Class Actions Seeking Injunctive Relief

Undeterred by the growing list of adverse court decisions, certain members of the plaintiff securities bar have now taken a new approach to attack executive compensation plans. In advance of a company's annual shareholder meeting, these law firms file shareholder actions seeking to enjoin a shareholder vote for the approval of the executive compensation plan. These suits have been brought as putative class actions instead of derivative shareholder suits—presumably to avoid the barrier of pleading demand futility, which was a basis for dismissal of many of the earlier suits. These class actions typically allege claims against directors for breach of fiduciary duty and against the company for aiding and abetting breach of fiduciary duty claims, and some suits assert a claim for violation of Section 14 of the Exchange Act. Plaintiffs typically assert that the proxy statements fail to provide adequate disclosure regarding the proposed executive compensation plan, including:

1. the information that the Board of Directors considered in making the recommendation to the shareholders to approve the executive compensation plan,
2. the reasons for the proposal,
3. the effects of the proposal,
4. why such proposal is in the best interests of the shareholders, and
5. why a compensation consultant was not engaged to analyze the proposed executive compensation.

Plaintiffs' firms have filed at least 18 of these types of suits in recent months, including 9 in the last month alone. These suits have met with some success:

- In two of the cases, the courts granted the plaintiffs' motion for a preliminary injunction. One of these cases subsequently settled, which allowed the shareholder vote to go forward. The settlement resulted in an award of $625,000 of attorneys' fees to the plaintiffs' firm and the company's agreement to provide supplemental proxy disclosures. The company in the other suit filed supplemental disclosures and postponed its shareholder meeting.
- The companies in five of the cases settled prior to a ruling on plaintiffs' motion for preliminary injunction. The settlements include supplemental disclosures and/or undertakings with respect to the company's corporate governance practices, and a payment of attorneys' fees and costs to plaintiffs' counsel for up to several hundred thousand dollars.
- In two of the cases, the plaintiffs voluntarily dismissed the action without settlement.
- In four of the cases, the court has not yet ruled on a motion for preliminary injunction and the cases remain pending. The shareholder meetings are scheduled to occur later in November.
- The same plaintiffs' firm filed 17 of the foregoing 18 suits. Indeed, this plaintiffs' firm has issued about two dozen press releases over the last two months announcing "investigations" of companies for potential breaches of fiduciary duty against directors for seeking shareholders' approval of the compensation of executive officers. This plaintiffs' firm may continue to file additional suits in the coming weeks because the annual shareholder meetings of several of the targeted companies have yet to occur. For a complete list of the current status and the jurisdictions in which cases have been filed, please see the attached charts.

Plaintiffs' Firms Gaining Steam in New Wave of Say-on-Pay (continued)

Conclusion

Plaintiffs' firms have succeeded in extracting payment of legal fees in the settlement of five of the recently filed putative class action suits seeking injunctive relief. It is tempting for companies to settle such suits in order to avoid the expense of litigation and any disruption of the scheduled shareholder meeting. However, settling with plaintiffs' firms will only incentivize them to continue filing such suits and extracting a toll on all public companies as a cost of doing business.

Companies can demonstrate that this latest ploy will not generate positive returns for the securities plaintiff bar only by fighting back and prevailing. Thus, companies should consider taking a principled stand and opposing motions for preliminary injunction. It is important to note that substantive changes in companies' proxy statement disclosures are unlikely to deter plaintiffs' firms from instituting these new putative class action suits seeking injunctive relief. Nonetheless, adequate disclosures will strengthen the ability of companies to succeed in opposing motions for preliminary injunction. Companies should remain diligent in ensuring that there are adequate disclosures in their proxy statements concerning executive compensation proposals.

If you have any questions about the content of this alert, please contact the Pillsbury Executive Compensation and Benefits attorney with whom you regularly work, or the authors below.

Sarah A. Good is a partner in the San Francisco and Silicon Valley offices. She can be reached at 415.983.1314 or sarah.good@pillsburylaw.com

Cindy V. Schlaefer is a partner in the Silicon Valley office. She can be reached at 650.233.4023 or cindy.schlaefer@pillsburylaw.com

Ana N. Damonte is a senior associate in the San Francisco office. She can be reached at 415.983.1013 or ana.damonte@pillsburylaw.com

Say-on-Pay Derivative Shareholder Suits against 22 Companies: 2010–2012

Disposition of Cases	No. of Cases	Percentage
Settled after Motion to Dismiss Denied	1	5%
Settled with No Ruling on Motion to Dismiss	3	13.5%
Motion to Dismiss Granted and Final	8	36%,
Motion to Dismiss Granted But Not Final Disposition	3	13.5%
Pending	7	32%
Total	**22**	**100%**

Plaintiffs' Firms Gaining Steam in New Wave of Say-on-Pay (continued)

Courts Granting Motions to Dismiss	
U.S. District Court - N.D. California - 2 cases	U.S. District Court - E.D. North Carolina
U.S. District Court - S.D. California	U.S. District Court - Oregon
U.S. District Court - Colorado	U.S. District Court - S.D. Texas
U.S. District Court - N.D. Illinois	Georgia Superior Court
U.S. District Court - Maryland	California Superior Court - Los Angeles County

Courts Denying Motion to Dismiss
U.S. District Court - S.D. Ohio

Jurisdiction[1]	No. of Cases
U.S. District Court - N.D. California	2
U.S. District Court - S.D. California (two state court cases removed and consolidated, then remanded to California Superior Court - San Diego County)	1
U.S. District Court - Colorado (2 cases consolidated)	1
U.S. District Court - Delaware	3
U.S. District Court - N.D. Illinois	1
U.S. District Court - Maryland	1
U.S. District Court - New Jersey	1
U.S. District Court - S.D. New York (3 cases consolidated)	1
U.S. District Court - E.D. North Carolina	1
U.S. District Court - N.D. Ohio (4 cases - 3 of which were consolidated)	2
U.S. District Court - S.D. Ohio	1
U.S. District Court - Oregon	1
U.S. District Court - S.D. Texas	3
California Superior Court - Los Angeles County	2
Delaware Court of Chancery	2
Georgia Superior Court - Fulton County	1
Texas State Court - Harris County	2

[1] In numerous circumstances, plaintiffs filed suits in multiple courts. Consolidated cases are listed as a single case. Cases not subsequently consolidated are counted separately.

Plaintiffs' Firms Gaining Steam in New Wave of Say-on-Pay (continued)

Recent Putative Class Actions Seeking Injunctive Relief Against 18 Companies: 2012

Disposition	No. of Cases	Percentage
Plaintiffs' motion for preliminary injunction granted	2	11%
Plaintiffs' motion for preliminary injunction denied	5	28%
No ruling on pending motion for preliminary injunction or plaintiff has not filed a motion for preliminary injunction yet	4	22%
Settled prior to ruling on plaintiffs' motion for preliminary injunction	5	28%
Plaintiff voluntarily dismissed case without settlement	2	11%
Total	**18**	**100%**

Courts Granting Motions for Preliminary Injunction
California Superior Court - Santa Clara County
U.S. District Court - N.D. California

Courts Denying Motions for Preliminary Injunction
California Superior Court - Santa Clara County - 2 cases
California Superior Court - Alameda County
New York Supreme Court - Suffolk County
U.S. District Court - N.D. Illinois

Jurisdiction	No. of Cases
California Superior Court - Alameda County	1
California Superior Court - Santa Clara County	4
Circuit Court of Missouri - Jackson County	1
Supreme Court of New York - County of New York	4
Supreme Court of New York - County of Suffolk	1
Supreme Court of New York - County of Albany	1
Supreme Court of New York - County of Nassau	1
Washington Superior Court - King County	1
U.S. District Court - N.D. California (including one case removed from Santa Clara Superior Court)	2
U.S. District Court - N.D. Illinois (after removal from Illinois state court)	1
U.S. District Court - S.D. New York	1
Total	**18**

Health Care Reform Update: New Medicare Tax Withholding Begins in 2013

By Mark C. Jones and Matthew C. Ryan[1]

The Internal Revenue Service ("IRS") recently released proposed regulations for the Additional Medicare Tax, a new levy on high-income taxpayers created by the Pension Protection and Affordable Care Act. The tax is charged solely to employees, but employers are responsible for withholding a portion of wages above $200,000, to be applied towards the tax. If an employer fails to withhold the proper amount, it may be liable for penalties and additions. Accordingly, employers should work with payroll staff and vendors to reform their withholding procedures before the new year begins.

The New Tax and Withholding Obligation

Under the Federal Insurance Contributions Act ("FICA"), employers must collect 2.9% of employee wages in order to fund Medicare. Half of this amount, or 1.45%, is withheld from employee wages, and the remaining half is paid by the employer. Beginning in 2013, the Additional Medicare Tax increases the employee portion of the Medicare tax by an additional 0.9% of wages in excess of certain thresholds (see table below).

Filing Status	Threshold Amount
Married filing jointly ("MFJ")	$250,000 / calendar year
Married filing separately ("MFS")	$125,000 / calendar year
Single, head of household or qualifying widow(er) with dependent child	$200,000 / calendar year

The Additional Medicare Tax differs from the standard Medicare tax in that (i) the tax is not imposed until the wages exceed the threshold amount and (ii) there is no employer portion corresponding to the amount owed by the employee.

The proposed regulations, issued on November 30, 2012, provide detail on employers' Additional Medicare Tax withholding obligations. Employers must withhold Additional Medicare Tax only to the extent that the wages paid by the employer to the employee exceed $200,000 within the calendar year. In performing its withholding obligations, the employer may disregard the employee's filing status and income from other sources, including wages paid to the employee's spouse. Withholding should not commence until the pay period in which calendar year wages exceed $200,000.

Examples: (1) Employer X pays Ann $150,000 annually. Ann's compensation is under $200,000, so no Additional Medicare Tax withholding is required. X does not withhold even if Ann informs X that she will be filing separately from her spouse, and thus will exceed the $125,000 MFS threshold. X does not withhold even if it employs Ann's spouse Ben and pays Ben $150,000 annually, thus placing Ann and Ben above the $250,000 MFJ threshold.

(2) X must withhold Additional Medicare Tax if it pays Carol $220,000 in 2013. This is true even if X knows Carol will file MFJ and her spouse does not work, thus bringing the couple below the $250,000 MFJ threshold. If Carol's wages are paid ratably twice a month, X will have paid Carol $192,500 prior to November 30, 2013. No withholdings should be made on those wages. On November 30th, X will pay Carol $9,166.67, pushing her current year wages to $201,666.67. X must withhold 0.9% of the last $1,666.67 of that paycheck and 0.9% of both December 2013 paychecks.

Health Care Reform Update: New Medicare Tax Withholding Begins in 2013 (continued)

Employers need not inform employees before making Additional Medicare Tax withholdings, but employers may wish to educate employees about the new tax, so that employees can plan for income tax liabilities. For instance, two spouses that individually earn less than $200,000—but jointly earn more than $250,000—might ask their employer(s) to make supplemental income tax withholdings in anticipation of their Additional Medicare Tax charge. To the extent that there is a mismatch between the amount withheld and the Additional Medicare Tax owed, the ultimate liability will be reconciled on the employee's income tax return.

Compensation Counted Towards the Additional Medicare Tax Threshold

When calculating the Additional Medicare Tax $200,000 withholding threshold, the employer must take care that all proper forms of compensation are included. The same compensation elements subject to FICA taxes generally are used for determining the Additional Medicare Tax. Beyond base salary, bonuses and commissions, employers must generally include the following items:

- Certain noncash fringe benefits;
- Restricted stock, restricted stock units and phantom stock, upon date of vesting;
- Nonqualified stock options and stock appreciation rights, upon date of exercise;
- Tips included as wages;
- Vacation allowances;
- Sick pay paid by a third party; and
- The imputed cost of group term life insurance exceeding $50,000 for current employees.

Withholding Errors, Sanctions and Correction Methods

Employers that fail to withhold the requisite 0.9% on wages above $200,000 are liable to the IRS for that amount until the corresponding Additional Medicare Tax is paid. Such an employer also faces a 20% penalty if the withholding error constituted negligence. In addition, the IRS may seek reporting penalties. The penalties and additions may apply even if the IRS collects the shortfall from the employee.

However, the proposed regulations clarify that employers may make an interest-free adjustment by submitting the missing withholding to the IRS along with an adjusted return (on Form 941-X) and a detailed explanation before both (1) the end of the calendar year in which the error occurred and (2) the due date for the return period during which the error was discovered (generally, the next Form 941 due date). The calendar year deadline may be extended if the underpayment was caused by an administrative error. Once an adjustment is properly filed, the employer may deduct the adjustment payment from future remuneration paid to the employee during the same calendar year.

We have been advising on health care reform since it was enacted in 2010 and providing guidance to employers on specific steps they should take to come into compliance with the law. If you have any questions, please contact the Pillsbury attorney with whom you regularly work or the author below.

[1] Law clerk awaiting admission to the bar

Mark Jones is a partner in the Los Angeles office. He can be reached at 213.488.7337 or mark.jones@pillsburylaw.com

For more information, please contact:

New York
Susan P. Serota
212.858.1125
susan.serota@pillsburylaw.com

Peter J. Hunt
212.858.1139
peter.hunt@pillsburylaw.com

Scott E. Landau
212.858.1598
scott.landau@pillsburylaw.com

Washington, DC
Howard L. Clemons
703.770.7997
howard.clemons@pillsburylaw.com

San Diego North County
Jan H. Webster
858.509.4012
jan.webster@pillsburylaw.com

San Francisco
Christine L. Richardson
415.983.1826
crichardson@pillsburylaw.com

Silicon Valley
Cindy V. Schlaefer
650.233.4023
cindy.schlaefer@pillsburylaw.com

Editors
Scott E. Landau
Susan P. Serota

Editorial Staff
Bradley A. Benedict
Kathleen D. Bardunias

For mailing list inquiries, please email
executivecomp@pillsburylaw.com

Pillsbury Winthrop Shaw Pittman LLP | 1540 Broadway | New York, NY 10036 | 877.323.4171 | www.pillsburylaw.com