

January 25, 2011

SEC ADOPTS SAY-ON-PAY RULES

To Our Clients and Friends:

At an open meeting held on January 25, 2011, the Securities and Exchange Commission ("SEC") voted to approve rules to implement the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") relating to shareholder advisory votes on executive compensation ("say-on-pay"), shareholder advisory votes on the frequency of conducting say-on-pay votes ("say-on-frequency") and shareholder advisory votes on compensation arrangements in connection with significant corporate transactions ("say-on-golden-parachutes"). The SEC did not address its proposed rules regarding disclosure by institutional investment managers of their votes on say-on-pay, say-on-frequency and say-on-golden-parachutes proposals but indicated at the open meeting that it will do so in the coming month. The final rules, adopted by a vote of 3 to 2, with Commissioners Casey and Paredes dissenting, were issued pursuant to Section 951 of the Dodd-Frank Act.

The SEC released the text of the final rules on the same day they were adopted, with the 152 page adopting release available [here](#). The rules were proposed in October 2010, which we described in detail in our October 19, 2010 client alert, available [here](#). A summary of the final rules is set forth below.

Key Aspects of the Final Rules

- The final rules adopted today are not effective until 60 days after they are published in the Federal Register. Nevertheless, companies now are subject to the Dodd-Frank Act's requirements to hold a say-on-pay and say-on-frequency vote, and thus should look to the SEC's rules for guidance on their proxy statement disclosures.
- Advisory votes on executive compensation do not require the filing of a preliminary proxy statement.
- In future years, companies will be required to discuss in the CD&A whether, and if so how, they considered the results of their most recent say-on-pay vote, and how that consideration affected the company's executive compensation decisions and policies; although some TARP companies may be required to include this disclosure in this year's CD&A.
- Companies are required to disclose their determination with respect to the frequency of future say-on-pay votes on a Form 8-K that generally will be due within 150 days after the vote and when conducting future say-on-pay votes will be required to disclose their current frequency policy as well as when the next vote will occur.

- A company can exclude say-on-pay shareholder proposals as substantially implemented only if a particular frequency was supported by a majority of votes cast in the most recent say-on-frequency vote and the company adopts a policy consistent with that vote.
- Smaller reporting companies are exempt from complying with the say-on-pay and say-on-frequency rules until 2013.

A. Applicability, Effective Date and Transition Issues

- **Which companies are subject to the final rules?**

All public companies that have a class of equity securities registered under Section 12 of the Securities Exchange Act of 1934 (the "Exchange Act") and are subject to the SEC's proxy rules (which excludes foreign private issuers), including smaller reporting companies (generally, companies with a public float of less than \$75 million), are subject to the final rules. As discussed below, although smaller reporting companies are not exempt from the final rules, they have a two-year delayed effective date with respect to the say-on-pay and say-on-frequency rules. In addition, companies participating in the Troubled Asset Relief Program ("TARP") must conduct a say-on-pay vote under TARP but generally are not required to comply with the Dodd-Frank Act say-on-pay and say-on-frequency rules until they have repaid all of their outstanding indebtedness under TARP.

- **When must companies comply with the final rules?**

Under the Dodd-Frank Act, companies are required to provide a say-on-pay and say-on-frequency vote at the first annual shareholders meeting occurring on or after January 21, 2011. However, the SEC rules adopted today do not become effective until 60 days following the publication of the rules in the Federal Register. We expect that companies filing proxy statements prior to the effective date nevertheless generally will look to the final rules in framing their say-on-pay and say-on-frequency disclosures. Smaller reporting companies do not have to hold say-on-pay or say-on-frequency votes until their first shareholders meeting at which directors are elected occurring on or after January 21, 2013.

All public companies, including smaller reporting companies, must comply with the say-on-golden-parachutes rules with respect to any merger proxy statement or other covered transactional document filed on or after April 25, 2011.

- **Are there any transition rules that companies can take advantage of?**

The adopting release extends the transition guidance provided in the proposing release by confirming that even prior to the final rules becoming effective, companies are not required to file preliminary proxy statements if the only matters that otherwise would require a preliminary proxy statement are the say-on-pay and say-on-frequency votes. In addition, as discussed below,

the final rules require shareholders to be able to vote among four choices with respect to the say-on-frequency proposal: "one year," "two years," "three years" or abstain. Although some proxy service providers have been able to implement this type of voting system, other proxy service providers (including vote tabulators) have not yet been able to reprogram their systems to facilitate the say-on-frequency vote in time for the first such votes. The adopting release confirms that the transition rule with respect to the voting choices on the proxy card for the say-on-frequency vote will continue until the end of 2011. As a result, companies are permitted to specify three choices on their proxy card for the say-on-frequency proposal -- "one year," "two years," or "three years" -- if their proxy service provider cannot reprogram its systems in time to accommodate the four required choices for the say-on-frequency votes in 2011. If shareholders execute and return a proxy but do not select one of these three choices, then companies would not be able to exercise discretion to vote the shares on a frequency recommended by the company, and the shares would not be voted on the proposal.

B. Say-on-Pay

- **What is say-on-pay?**

The final rules add new Exchange Act Rule 14a-21(a) to require public companies to hold a shareholder advisory vote on executive compensation at least once every three calendar years. The adopting release makes clear that the say-on-pay rules only apply for annual shareholders meetings at which directors will be elected, or a special meeting in lieu of such meeting.

- **What is the scope of the vote?**

As proposed, the final rules require that the say-on-pay vote be to approve the compensation of the company's named executive officers, as disclosed under Item 402 of Regulation S-K (which includes the Compensation Discussion and Analysis ("CD&A"), the compensation tables and the other narrative compensation disclosures). The adopting release states that a say-on-pay vote to approve generally a company's compensation policies and procedures would not satisfy the statutory say-on-pay requirement. The final rules provide that the say-on-pay vote does not encompass any disclosure required under Item 402(s) of Regulation S-K of risks arising from a company's employee compensation programs (although it would encompass any disclosure included in the CD&A of risks arising from a company's named executive officer compensation programs).

- **Must the say-on-pay vote be phrased as a resolution?**

The final rules do not require companies to use any specific language or form of resolution to be voted on by shareholders. The final rules require that the resolution indicate that the say-on-pay vote "is to approve the compensation of the registrant's named executive officers as disclosed pursuant to Item 402 of Regulation S-K." Although the final rules and adopting release do not specifically address whether the proposal must be phrased with a formal "Resolved" clause, we expect that many companies will find it convenient to do so. The final rules provide a non-exclusive example of a resolution that satisfies the rules: "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."

- **What must companies disclose in the proxy statement?**

As proposed, the final rules add new Item 24 to Schedule 14A to require companies to disclose in the proxy statement that they are holding a say-on-pay vote pursuant to the Exchange Act and explain the general effect of the vote, including whether the vote is non-binding. In addition, the final rules require companies to disclose their current frequency for conducting say-on-pay votes as well as when the next say-on-pay vote will occur. The adopting release clarifies that this additional disclosure is not required in a company's first year of conducting say-on-pay and say-on-frequency votes.

- **What must companies disclose in future CD&As?**

The final rules amend Item 402(b) of Regulation S-K to require companies to address in subsequent years' CD&As whether, and if so how, they considered the results of their most recent say-on-pay vote required under either Section 14A of the Exchange Act or Exchange Act Rule 14a-20 (say-on-pay votes required for companies participating in TARP), and how that consideration has affected the company's executive compensation decisions and policies. Thus, TARP companies filing a proxy statement after the final rules become effective are required to address in this year's CD&A whether and if so how they have taken into account the results of the most recent say-on-pay vote, but companies that voluntarily conducted say-on-pay votes prior to January 21, 2011 are not. As proposed, this disclosure requirement is included in the list of mandatory topics to cover in the CD&A rather than the list of examples of topics that may be appropriate for companies to address. This requirement thus applies even if, for example, the consideration of a favorable say-on-pay vote was not a material factor in a subsequent decision to change executive compensation programs.

C. Say-on-Frequency

- **What is say-on-frequency?**

The final rules add new Exchange Act Rule 14a-21(b) to require public companies to hold at least once every six calendar years a separate shareholder advisory vote on whether the say-on-pay vote should be held every one, two or three years. The adopting release makes clear that the say-on-frequency rules only apply for annual shareholders meetings at which directors will be elected, or a special meeting in lieu of such meeting.

- **Is there a specific form of resolution that must be used?**

As proposed, the final rules do not specify a form of resolution for the say-on-frequency vote. Although the final rules and adopting release do not specifically address whether the proposal must be phrased with a formal "Resolved" clause, absent interpretative guidance from the SEC staff to the contrary, we believe that the SEC's decision not to provide a form of resolution allows companies to determine the most effective means of presenting this proposal and that many companies will choose not to structure it using a formal "Resolved" clause.

- **What voting options must be included in the proxy card?**

As proposed, the final rules require that companies allow shareholders to cast their say-on-frequency vote by choosing from among the following four choices on the proxy card: one year, two years, three years, or abstain from voting on the proposal. In order to accommodate this, the final rules create an exception to Exchange Act Rule 14a-4, which currently provides that proposals (other than the election of directors) may be structured only as "for," "against" or "abstain" votes. As noted above, this requirement is subject to transition relief that is available through 2011.

- **What must companies disclose in the proxy statement?**

The disclosure requirements under new Item 24 to Schedule 14A for say-on-frequency votes are the same as those discussed above for say-on-pay votes. In addition, the adopting release references the discussion in the proposing release that, although boards may make a recommendation as to the frequency of future say-on-pay votes, the proposal must make it clear that the say-on-frequency vote is not a vote to approve or disapprove the board's recommendation. The adopting release indicates that, consistent with current Exchange Act Rule 14a-4, if companies do not include a recommendation as to the say-on-frequency vote, then they do not have discretionary voting authority to vote shares on the say-on-frequency proposal if the shareholder returns a proxy but does not specify a choice of frequency.

- **Are there any implications of the say-on-frequency vote?**

The final rules require companies to disclose on Form 8-K their decisions regarding how frequently they will hold a say-on-pay vote in light of the results of the say-on-frequency vote. Companies are required to file this Form 8-K by the following deadlines:

- no later than 150 calendar days after the date of the meeting at which the say-on-frequency vote occurred; and
- no later than 60 calendar days prior to the deadline for submission of Rule 14a-8 shareholder proposals for the next annual meeting (which generally is 120 calendar days before the anniversary of the release date of the company's proxy statement in connection with the previous year's annual meeting).

The proposed rules would have required companies to disclose these decisions in their quarterly reports on Form 10-Q for the period during which the say-on-frequency vote occurs (or in their annual reports on Form 10-K if the vote was held during the fourth quarter).

D. Other Aspects of the Say-on-Pay and Say-on-Frequency Rules

- **Are the say-on-pay and say-on-frequency votes non-binding?**

The adopting release confirms that the say-on-pay and say-on-frequency votes will be non-binding on a company and its board of directors.

- **Do the final rules specify a voting standard for approval of the say-on-pay and say-on-frequency votes?**

The final rules do not prescribe a voting standard for approval of the say-on-pay and say-on-frequency proposals. However, companies will need to state in their proxy statements the vote required for approval of these proposals as well as the method by which votes will be counted, pursuant to existing Item 21 of Schedule 14A. In the absence of interpretative guidance from the SEC staff to the contrary, we believe that companies' default state law voting standards will be viewed as applicable to these votes, although, as with other non-binding votes, companies may carefully evaluate the voting results regardless of whether the proposal is deemed to have passed under state law.

- **Does a company need to adopt a policy on the frequency of future say-on-pay votes?**

Although not explicitly required by the final rules, a number of aspects of the final rules may lead companies to adopt a policy on the frequency of future say-on-pay votes. Specifically, the treatment of shareholder proposals, the new Form 8-K disclosure requirement, and the requirement that companies disclose at the time of a say-on-pay vote when the next vote will occur, each have implications that may have the practical effect of limiting companies' ability to change the frequency of their say-on-pay votes.

- **Do brokers, banks and other nominees have discretion to vote uninstructed shares with respect to the say-on-pay and say-on-frequency votes?**

Pursuant to other provisions of the Dodd-Frank Act, the say-on-pay and say-on-frequency votes are executive compensation matters on which brokers are not permitted to vote uninstructed shares.

- **How do the final rules affect shareholder proposals?**

The final rules amend Exchange Act Rule 14a-8 to address the status of shareholder proposals that seek a say-on-pay vote or relate to the frequency of say-on-pay votes by expressly permitting companies to exclude such proposals as substantially implemented under Rule 14a-8(i)(10) if:

- there is a majority of votes cast with respect to a particular frequency in the company's most recent say-on-frequency vote; and
- the company adopts a policy on the frequency of say-on-pay votes that is consistent with the frequency that received a majority of votes cast.

The final rules clarify that this exclusion includes binding shareholder proposals that seek to amend a company's governing documents. The final rules are narrower than the proposed rules, which would have permitted exclusion of these shareholder proposals if the company adopted a frequency policy consistent with the choice selected by the plurality of votes cast.

- **Are companies required to file a preliminary proxy statement in connection with the say-on-pay or say-on-frequency vote?**

As proposed, the final rules amend Exchange Act Rule 14a-6(a) to provide that inclusion of a say-on-pay vote in the proxy statement will not require the filing of a preliminary proxy statement. In addition, the final rules clarify that any advisory vote on executive compensation, whether mandated pursuant to the final rules or voluntarily conducted, will not trigger the preliminary proxy statement filing requirement.

E. Say-on-Golden-Parachutes

- **What is say-on-golden-parachutes?**

The final rules add new Item 402(t) of Regulation S-K to require public companies, in connection with certain specified significant corporate transactions, to provide disclosure of all written or unwritten agreements or understandings that the soliciting company has with its named executive officers or the named executive officers of the acquiring company (if the soliciting company is the target company) with respect to compensation that is based on or otherwise relates to such transaction. In addition, under new Exchange Act Rule 14a-21(c), these companies are required to hold a separate shareholder advisory vote on these compensation arrangements unless all of the transaction-related compensation agreements and understandings were the subject of a prior say-on-pay vote. The final rules make clear that arrangements between the soliciting target company's named executive officers and the acquiring company would be required to be disclosed pursuant to Item 402(t), but would not be required to be subject to the say-on-golden-parachute vote.

- **What kinds of transactions trigger the say-on-golden-parachutes rules?**

The final rules require disclosure of golden parachute compensation arrangements under Item 402(t) in connection with shareholders meetings at which shareholders are asked to approve an acquisition, merger, consolidation or a proposed sale or other disposition of all or substantially all assets, and in connection with Exchange Act Rule 13e-3 going private transactions and third party tender offers. A say-on-golden parachutes vote with respect to these arrangements only is required in connection with shareholders meetings at which shareholders are asked to approve an acquisition, merger, consolidation or a proposed sale or other disposition of all or substantially all assets.

- **Are there any exemptions from holding a say-on-golden-parachutes vote?**

As proposed, the final rules require a say-on-golden-parachutes vote unless the golden parachute arrangements, as disclosed under new Item 402(t) of Regulation S-K, were subject to a prior say-on-pay vote. Companies that want to take advantage of this exception would have to voluntarily include disclosure in their annual meeting proxy statements about change-in-control arrangements in a manner that satisfies new Item 402(t) rather than existing Item 402(j) (amounts payable upon termination of employment separate from a change-in-control would still need to be disclosed pursuant to the existing Item 402(j) rules). The final rules provide that this exception will not apply to new golden parachute arrangements or to golden parachute

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arrangements that were revised subsequent to the prior say-on-pay vote. However, the exception will apply if the only changes to the golden parachute arrangements, as disclosed under Item 402(t), would be to reflect movements in the company's stock price or to reflect a reduction in the value of the total compensation payable. While these rules may lead companies to adopt change-in-control compensation arrangements so that such arrangements are not first disclosed at the time of a transaction, companies will need to carefully evaluate whether to take advantage of this exception given the enhanced disclosure that will be required in their annual meeting proxy statements and the limited scope of the exception if the golden parachute arrangements change after the say-on-pay vote.



Gibson, Dunn & Crutcher's lawyers are available to assist in addressing any questions you may have regarding these issues. Please contact the Gibson Dunn attorney with whom you work, or any of the following:

John F. Olson - Washington, D.C. (202-955-8522, jolson@gibsondunn.com)

Brian J. Lane - Washington, D.C. (202-887-3646, blane@gibsondunn.com)

Ronald O. Mueller - Washington, D.C. (202-955-8671, rmueller@gibsondunn.com)

Amy L. Goodman - Washington, D.C. (202-955-8653, agoodman@gibsondunn.com)

James J. Moloney - Orange County, CA (949-451-4343, jmoloney@gibsondunn.com)

Stephen W. Fackler - Palo Alto, CA (650-849-5385, sfackler@gibsondunn.com)

Sean C. Feller - Los Angeles, CA (213-229-7579, sfeller@gibsondunn.com)

Elizabeth A. Ising - Washington, D.C. (202-955-8287, eising@gibsondunn.com)

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