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# SEC PROPOSES RULES FOR SAY-ON-PAY AND SAY-ON-GOLDEN-PARACHUTE VOTES

To Our Clients and Friends:

On October 18, 2010, the Securities and Exchange Commission ("SEC") proposed rules, available here, to implement the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") relating to: (1) shareholder advisory votes on executive compensation ("say-on-pay"); (2) shareholder advisory votes on the frequency of say-on-pay votes ("say-on-frequency"); and (3) shareholder advisory votes on compensation arrangements in connection with significant corporate transactions ("say-on-golden-parachutes"). The proposal includes transition provisions that companies may rely on until final rules are adopted. The SEC also proposed rules, available here, relating to disclosure by institutional investment managers of their proxy voting on executive compensation and other matters. Both rule proposals were issued pursuant to Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which we described in detail in our July 21, 2010 client memorandum, available here. Comments on the proposed rules should be submitted on or before November 18, 2010.

## A. Say-on-Pay

The proposed rules would add new Rule 14a-21(a) under the Securities Exchange Act of 1934 (the "Exchange Act") to require public companies to hold a shareholder advisory vote on executive compensation at least once every three years. The proposed rules provide the following:

- ***Scope of the Vote***. The proposed rules would not prescribe the specific language or form of shareholder resolution, but would 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 proposing 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 proposed rules provide that the say-on-pay vote would 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).

- ***Proxy Disclosure***. The proposed rules would add new Item 24 to Schedule 14A to require companies to disclose in the proxy statement that they are providing a say-on-pay vote pursuant to the Exchange Act and explain the general effect of the vote, such as that the vote is non-binding. However, companies would not be required to state what action they would expect to take in response to a say-on-pay vote.

- ***No Preliminary Proxy Filing***. The proposed rules would amend Exchange Act Rule 14a-6 to provide that inclusion of a say-on-pay vote in the proxy statement would not require the filing of a preliminary proxy statement.

- ***Future CD&A Disclosure***. The proposed rules would amend Item 402(b) of Regulation S-K to require companies to address in the CD&A whether and if so how they have taken into account the results of prior say-on-pay votes required under either Section 14A of the Exchange Act (which would include say-on-pay votes required under the proposed rules but would exclude say-on-pay votes voluntarily held by companies) or Exchange Act Rule 14a-20 (say-on-pay votes required for companies participating in the Troubled Asset Relief Program ("TARP")) with respect to their compensation policies and decisions. This disclosure requirement would be 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.

**B. Say-on-Frequency**

Proposed Exchange Act Rule 14a-21(b) would require public companies to hold at least once every six years a separate shareholder advisory vote on whether the say-on-pay vote should be held every one, two or three years. The proposed rules provide the following:

- ***Voting Mechanics***. The proposed rules would require that companies allow shareholders to cast their say-on-frequency vote by choosing from among the following four choices on the proxy: one year, two years, three years, or abstain from voting on the proposal. In order to accommodate this, the proposed rules would 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.

- ***Proxy Disclosure***. The proposed rules would add new Item 24 to Schedule 14A to require companies to disclose in the proxy statement that they are holding a say-on-frequency vote pursuant to the Exchange Act and explain the general effect of the vote, such as that the vote is non-binding. The proposing release states that the SEC expects that boards will make a recommendation as to the frequency of the say-on-pay vote but must make it clear that the say-on-frequency vote is not a vote to approve or disapprove the board's recommendation.

- ***No Preliminary Proxy Filing***. The proposed rules would amend Exchange Act Rule 14a-6 to provide that inclusion of a say-on-frequency vote in the proxy statement would not require the filing of a preliminary proxy statement.

- ***Effect on Shareholder Proposal Rules***. The proposed rules would 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 the following conditions are met: (1) the company has adopted a policy on the frequency of say-on-pay votes that is consistent with the choice selected by the plurality of votes cast in the most recent say-on-frequency vote; and (2) the company provides a say-on-frequency vote at least once every six years.

- ***Form 10-Q and Form 10-K Disclosure***. The proposed rules would require companies to disclose 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) their decisions regarding how frequently they will hold a say-on-pay vote in light of the results of the say-on-frequency vote.

The proposing release also provides for the following with respect to both say-on-pay and say-on-frequency votes:

- ***Advisory Nature of the Votes***. The proposing release confirms that the say-on-pay and say-on-frequency votes would be non-binding on a company and its board of directors. The proposed rules therefore would not prescribe a voting standard for approval of the say-on-pay and say-on-frequency votes.

- ***Broker Discretionary Voting***. The proposing release confirms that the say-on-pay and say-on-frequency votes are executive compensation matters on which brokers are not permitted to vote uninstructed shares, as required by Section 957 of the Dodd-Frank Act.

- ***Applicability to TARP Companies***. The proposed rules would not require companies that are required to provide annual say-on-pay votes under TARP to hold an additional say-on-pay vote or hold a say-on-frequency vote until they have repaid all indebtedness under TARP.

**C. Transition Issues**

Under the Dodd-Frank Act, public companies are required to hold say-on-pay and say-on-frequency votes at any annual or other shareholder meeting occurring on or after January 21, 2011. The proposed rules make clear that any preliminary or definitive proxy statement filed for a meeting occurring on or after such date must include these votes even if the SEC's final rules are not yet in place. For companies holding meetings on or after January 21, 2011 that must file proxy materials before the SEC has finalized these proposed rules, the proposing release provides that such companies will not be required to file a preliminary proxy statement if the only ballot items that otherwise would require a preliminary filing are the say-on-pay and say-on-frequency votes required by the Dodd-Frank Act.

Another transition issue addressed by the proposing release is the uncertainty regarding whether proxy service providers (such as Broadridge Financial Solutions, Inc., which administers proxy voting of shares for the customers of many brokerage firms) will be able to reprogram their systems to facilitate the say-on-frequency vote in time for the first such votes. Currently, shareholders are able to vote only among three choices: "for," "against," or "abstain." As discussed above, the say-on-frequency vote would require shareholders to be able to vote among four choices. The proposing release states that if proxy service providers cannot reprogram their systems in time for the first required say-on-frequency votes, and until final rules are issued, companies may include only three choices on their proxy for the say-on-frequency proposal: "one year," "two years," or "three years." 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.

**D. Say-on-Golden-Parachutes**

Under proposed new Item 402(t) of Regulation S-K, in connection with shareholder approval of an acquisition, merger, consolidation or proposed sale or disposition of all or substantially all of a company's assets, public companies would be required 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 proposed new Exchange Act Rule 14a-21(c), these companies would be 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.

Specifically, the proposed rules provide the following:

- ***Tabular Disclosure***. The proposed rules would specify a tabular disclosure format for compensation arrangements covered by the provision that is different in some respects from the disclosure of change-in-control and post-termination arrangements currently required under Item 402(j) of Regulation S-K (which is not required to be provided in tabular form). Under the proposed rules, companies would be required to include a table quantifying for each named executive officer the value of: (1) cash severance payments; (2) accelerated vesting of equity awards and payments made in cancellation of equity awards; (3) enhancements to pension or non-qualified deferred compensation benefits; (4) perquisites (even if de minimis); (5) tax gross-ups; (6) any other benefits (including benefits pursuant to arrangements that are available generally to all salaried employees and do not discriminate in scope, terms or operation in favor of the named executive officers); and (7) the total of all such payments and benefits. The proposed rules would require footnote disclosure showing which amounts in the table are triggered by the covered transaction (single trigger) and which amounts are contingent upon additional conditions, such as termination of employment (double trigger). The proposed rules would not require disclosure of previously vested equity awards, information already disclosed in the annual meeting proxy statement in the Pension Benefits or Non-qualified Deferred Compensation tables or compensation payable pursuant to post-transaction employment agreements to be entered into in connection with the transaction (although such post-transaction employment agreements may be required to be disclosed pursuant to Item 5 of Schedule 14A).

- ***Narrative Disclosure***. Similar to the current proxy disclosure rules for change-in-control and post-termination arrangements, companies would be required to describe: (1) any material conditions or obligations to the receipt of payments or benefits (including restrictive covenants, their duration and provisions regarding the waiver of such covenants); (2) the specific circumstances that would trigger payment; (3) whether payments would be lump sum or annual and the duration of the payments; (4) by whom the payments would be made; and (5) any other material factors regarding each agreement, including, for example, modification of outstanding options to extend the vesting period or post-termination exercise period or to lower the exercise price.

- ***Shareholder Vote***. The proposed rules would require a separate shareholder advisory vote on the compensation disclosure described above unless such compensation was included in the executive compensation disclosure that was the subject of 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 proposed rules provide that this exception would not apply to new golden parachute arrangements or revisions to golden parachute arrangements that were subject to the prior say-on-pay vote. The proposed rules solicit comment as to whether certain types of revisions should be exempt and not trigger a separate say-on-golden-parachute vote, including whether there should be an exemption for golden parachute arrangements previously subject to a say-on-pay vote if the only change is the subsequent grant, in the ordinary course, of additional equity awards that are subject to the same acceleration provisions that applied to those awards already covered by the previous vote. The proposed rules also 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. In addition, new employment agreements between the target company's named executive officers and the acquiring company relating to services to be performed after the closing of the transaction neither would be required to be disclosed under Item 402(t) nor would be subject to the say-on-golden-parachute vote, although companies may be required to disclose those arrangements pursuant to existing Item 5 of Schedule 14A.

**E. Reporting of Proxy Votes on Executive Compensation and Other Matters**

The proposed rules would require that institutional investment managers subject to Section 13(f) of the Exchange Act, generally consisting of persons that have more than $100 million of publicly traded U.S. equity securities under management, file with the SEC annually a report disclosing their votes on any say-on-pay, say-on-frequency and say-on-golden-parachute proposals, unless the votes are otherwise required to be reported publicly by SEC rules. Although investment companies, including mutual funds, already are required to disclose how they voted shares they hold on all matters, these provisions expand this reporting to hedge funds and other large shareholders in the context of the Dodd-Frank Act's new compensation voting requirements. Under the proposed amendments, institutional investment managers would be required to identify the securities voted and provide a description of the matters voted on, how the shares were voted and whether the vote was for or against management's recommendation.

The proposed amendments would require institutional investment managers to report these votes not later than August 31 of each year, for the twelve months ended June 30. Accordingly, if the proposed amendments are adopted, institutional investment managers would be required to file their first reports at meetings that occur on or after January 21, 2011 and ending on June 30, 2011.

*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:*

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