BAKER & McKENZIE

Client Alert

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You're Invited

Baker & McKenzie and **Towers Watson** invite you to attend a live webinar on October 28, 2010 at 1pm Eastern to address say-on-pay under the proposed rules. More information about the event is available at http://www.bakermckenzie.com/ewbnasayonpaygoldenparachutesoct10/

The full text of the proposed rules is available at http://www.sec.gov/rules/proposed/2010/33-9153.pdf

For additional information, please see our Dodd-Frank Wall Street Reform And Consumer Protection Act website at http://www.bakermckenzie.com/financialreform

Say-On-Pay: SEC Issues Proposed Rules Regarding Advisory Votes on Executive Compensation and Golden Parachutes

In accordance with its rigorous rulemaking schedule to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Act"), the Securities and Exchange Commission released proposed rules[1] on October 18, 2010 regarding shareholder advisory votes on executive compensation and golden parachute arrangements.

The proposals would clarify and implement new Section 14A of the Securities Exchange Act of 1934 ("Exchange Act") which:

- Mandates separate shareholder advisory votes on executive compensation and the frequency of such say-on-pay votes;
- Requires companies soliciting votes to approve merger or acquisition transactions to conduct shareholder votes on golden parachute arrangements in connection with such transactions; and
- Imposes related disclosure requirements.

The rules also propose amendments to Rule 14a-4 under the Exchange Act to make conforming changes to the requirements for the form of proxy and to Rule 14a-8 to include in the list of permissible excludable shareholder proposals those that seek say-on-pay advisory and/or frequency votes in certain circumstances. Comments on the proposals are due on or before November 18, 2010.

This Client Alert addresses the proposals and related conforming amendments and provides responses to commonly asked questions to assist you with preparation for the upcoming proxy season and beyond. For practical considerations applicable to the upcoming proxy season, please consult our July 16, 2010 newsletter available at http://www.bakermckenzie.com/alnacsexecutivecompensationcorporategovernancereformjul10/

This is the first of several client newsletters related to SEC rulemaking to implement provisions of the Dodd-Frank Act.

[1] The proposed rules implement Section 951 of the Act.

Say-On-Pay – Three New Votes

New Section 14A of the Exchange Act requires companies to conduct separate shareholder advisory votes to approve the compensation of named executive officers at least once every three years and to enable shareholders to determine, at least once every six years, the frequency with which such advisory vote on executive compensation must be sought (*i.e.*, every 1, 2 or 3 years). In addition, Section 14A also requires companies soliciting votes to approve merger or acquisition transactions to conduct a separate shareholder advisory vote to approve golden parachute compensation arrangements (compensation, whether present, deferred, or contingent, 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 issuer).[2]

Under new Section 14A, all of the shareholder votes are non-binding and none may be construed to overrule a decision of the issuer or board of directors, nor do they change any existing, or create or imply any additional fiduciary duties for such issuer or the board of directors.

Applicability. Issuers subject to the rules, if adopted, include those companies with equity securities registered under Section 12 of the Exchange Act that are subject to the SEC's proxy rules.[3]

Effective date. Under Section 14A of the Exchange Act, the separate resolutions to approve executive compensation and to decide upon the frequency of such vote are required to be included in proxy statements, whether in preliminary or definitive form, for annual or other shareholder meetings occurring on or after January 21, 2011, whether or not the SEC has adopted the related disclosure rules discussed in this Alert by that time.[4]

Both the disclosure of golden parachute compensation arrangements under proposed new Item 402(t) of Regulation S-K and the separate advisory vote to approve certain golden parachute compensation arrangements in accordance with proposed new Rule 14a-21(c) are not required to be included in merger proxy statements relating to a meeting of shareholders *until* the SEC adopts final rules under the Act.[5]

Say-on-Pay: Executive Compensation and Frequency

Under the SEC's proposed Rule 14a-21(a), the separate shareholder advisory vote on executive compensation would be required only when proxies are solicited for an annual or other meeting of shareholders where disclosure of executive compensation under Item 402 of Regulation S-K is required.

[2] See proposed Rule 14a-21 (a-c).

[3] Smaller reporting companies are subject to the new requirements to provide the three separate shareholder advisory votes. Applicability for companies under the Troubled Asset Relief Program (TARP) is briefly addressed on page 7 of this Client Alert.

[4] See our FAQ's on page 7 of this Alert.

[5] See the SEC's Proposing Release at page 9.

What type of compensation is covered? This shareholder advisory vote will take into account the compensation as disclosed in the issuer's Compensation Discussion and Analysis (CD&A), the compensation tables, and other narrative executive compensation disclosures required by Item 402.[6] Although the proposed rule does not mandate any specific resolution or form of language to be used, the rule is clear that the vote must take into consideration all executive compensation disclosure required by Item 402. Consistent with Section 14A of the Exchange Act, however, compensation of directors is ***not*** subject to the advisory vote.

In addition, regulations adopted by the SEC last year[7] required issuers to include disclosure in the CD&A if risk considerations were a material part of the issuer's compensation policies or decisions for named executive officers. If such disclosure is included in proxy materials for meetings on or after January 21, 2011, such disclosure ***would be*** considered by shareholders when voting on executive compensation.[8]

Smaller reporting companies are subject to scaled disclosure requirement and are not required to include the CD&A. Accordingly, smaller reporting companies would not be required to include a CD&A to comply with proposed Rule 14a-21.

Shareholder vote on frequency. Proposed Rule 14a-21(b) would require an issuer to provide a separate shareholder vote in proxy statements for annual meetings to determine whether the shareholder vote on the compensation of executives is required every 1, 2 or 3 years. This proposed rule would also clarify that the advisory vote on frequency must only be provided in a proxy statement for an annual or other meeting for which compensation disclosure is required.

Disclosure requirements

Proposed new Item 402(b) to Regulation S-K. The SEC's proposed amendments to implement Section 14A of the Exchange Act also propose new disclosure requirements for executive compensation under Regulation S-K. Under existing Item 402(b) of Regulation S-K, issuers must explain all material elements of their named executive officers' compensation by addressing mandatory principles-based topics in their CD&A, such as the "how" and "why" of the company's compensation programs and decisions.

Proposed amendments to Item 402(b) would require new disclosure in the CD&A to address whether, and if so, how, the issuer's compensation policies and decisions reflect the results of the shareholder advisory votes on executive compensation. Although this new disclosure requirement, if adopted, was not

[6] Note that issuers may voluntarily include disclosure of golden parachute arrangements required by proposed Item 402(t) discussed on page 4 of this Alert in their annual meeting proxy statements. If this is the case, the compensation would be subject to the shareholder advisory vote on executive compensation and would not need to be voted upon again in a separate resolution.

[7] For more information on this, see our January 2010 Client Alert available at http://www.bakermckenzie.com/alnacorporatesecuritiesnewitems2010proxyseasonjan10/

[8] However, the company's disclosures pursuant to Regulation S-K Item 402(s) about its compensation policies and practices as they relate to risk management and risk taking-incentives for employees generally would not be subject to the say-on-pay vote.

mandated specifically by the Act, the SEC believes that this information is important to better facilitate a shareholder's understanding of the particular company's compensation decisions.[9]

Proposed new Item 24 to Schedule 14A. Proposed Item 24 to Schedule 14A would require issuers to disclose that they are providing a separate shareholder resolution on executive compensation and to briefly explain the general effect of the vote, for example, that the vote is nonbinding in nature. This disclosure is also required for the shareholder advisory vote on frequency.

Golden Parachutes

In the event of an acquisition, merger, consolidation, sale or other disposition of all or substantially all the assets of an issuer requiring shareholder approval, Section 14A of the Exchange Act requires companies to provide a nonbinding advisory vote in respect of any compensation payments (whether present, deferred or contingent) that may be paid or become payable to named executive officers in connection with such business combination.

Section 14A of the Exchange Act also requires all persons making a proxy or consent solicitation seeking shareholder approval of such transaction to provide disclosure of any agreements or understandings that the soliciting person has with its named executive officers (or those of the acquiring issuer) concerning compensation based on or relating to the merger transaction. Disclosure relating to any agreements or understandings the acquiring issuer has with its named executive officers and that it has with executive officers of the target company in transactions in which the acquiring issuer is making a proxy or consent solicitation in seeking shareholder approval of an acquisition, merger, consolidation, sale or other disposition of all or substantially all the assets of an issuer is also required.

Existing rules. Currently, SEC rules require a target company soliciting shareholder approval of a merger to briefly describe any substantial interest, whether direct or indirect, of any person who has been a named executive officer or director since the beginning of the last fiscal year in any matter to be acted upon. In addition, existing rules require companies to provide detailed information in annual reports and annual meeting proxy statements about payments to be made to named executive officers upon termination of employment or in connection with a change in control.[10]

Proposed new Item 402(t). Although the existing rules require certain disclosures about golden parachutes, they do not include detailed requirements for such disclosures applicable to proxy or consent solicitations for approval of the

[9] Although smaller reporting companies are not required to include the CD&A disclosure, such entities are subject to Item 402(o) of Regulation S-K which requires a narrative description of any material factors necessary to aid in a shareholder's understanding of the items provided in the Summary Compensation Table. If a smaller reporting company considered prior executive compensation votes material, disclosure would be required.

[10] See Item 402(j) of Regulation S-K. The disclosures required by Item 402(j) are not affected by these proposals.

transaction. As proposed, new Item 402(t)[11] would require disclosure of all golden parachute compensation relating to the merger among the target and acquiring companies and the named executive officers of each entity to address the full scope of the golden parachute compensation applicable to the transaction.

New proposed Item 402(t) would require disclosure of the named executive officers' golden parachute payments in tabular and narrative form. The proposed new tabular disclosure would require quantification with respect to any agreements or understandings, whether written or unwritten, between each named executive officer and the acquiring company or the target company, concerning any type of compensation (deferred or contingent) based on or related to a merger, acquisition, sale, consolidation or other disposition of all or substantially all of the assets. The individual elements of compensation, such as cash severance, equity awards that are accelerated or cashed out, pension and nonqualified deferred compensation enhancements, perquisites and tax reimbursements, would be quantified and a total compensation number for each named executive officer provided.[12]

Disclosure under proposed Item 402(t) would be required in any proxy or consent solicitation for a meeting at which shareholders are asked to approve an acquisition, merger, consolidation or sale of the issuer's assets.

Shareholder advisory vote. Proposed Rule 14a-21 would require a company soliciting proxies to approve an acquisition, merger or similar transaction, to provide its shareholders an advisory vote to approve golden parachute arrangements disclosed pursuant to Item 402(t). This vote would only cover arrangements between the company seeking the shareholder vote and its named executive officers, even though Item 402(t) would require broader disclosure.

Relationship between the say-on-pay on golden parachutes and the say-on-pay on executive compensation. If an issuer conducts an advisory vote on executive compensation that includes all the required disclosure with regard to a golden parachute compensation say-on-pay vote, a subsequent advisory vote with respect to the same golden parachute compensation need not be provided. If, after the advisory vote, the issuer adopts new golden parachute arrangements or modifies any of the existing arrangements, a separate vote on the new or modified arrangements would be required.

Conforming amendments. The SEC's proposals also seek to amend Schedule 14A, 14C, 14D-9, 13E-3 and Item 1011 of Regulation M-A to require disclosure of golden parachute arrangements as follows:[13]

- Information statements filed pursuant to Regulation 14C;

[11] Note that the proposals include an exception to the disclosure obligations with respect to agreements and understandings with senior management of foreign private issuers where the target or acquirer is a foreign private issuer.

[12] Note that the proposing release includes an instruction to Item 402 that provides guidance with respect to disclosure where uncertainties exist.

[13] Note that the proposals contain an exception to the disclosure requirements for bidders and targets in third-party tenders and filing persons in 13e-3 going private transactions where the target or subject company is a foreign private issuer.

- Proxy or consent solicitations that do not require merger proposals but require disclosure of information under Item 14 of Schedule 14A (for example, the solicitation of proxies to approve the issuance of shares or a reverse stock split in order to conduct a merger transaction);

- Registration statements on Forms S-4 and F-4 containing disclosures relating to mergers and similar transactions;

- Going private transactions;

- Third party tender offers and Schedule 14D-9 solicitation/recommendations; and

- Disclosure by the bidder in third party tender offers about a target's golden parachute arrangements in certain circumstances.

Other proposed amendments

Form of proxy. Rule 14a-4 under the Exchange Act currently provides requirements as to the form of proxy that issuers must include with their proxy materials to shareholders (*i.e*., a means to specify choices for the approval, disapproval or abstention for each matter to be acted upon, other than elections to office). The proposed amendments to Rule 14a-4 would revise this standard to permit proxy cards to allow shareholders to vote 1, 2 or 3 years, or "abstain" for the frequency vote to approve executive compensation.

As set forth in the SEC's proposing release, the Commission "expect[s] that the board of directors will include a recommendation as to how shareholders should vote on the frequency of shareholder votes on executive compensation." However, the amendments to Rule 14a-4 are not to be construed as a means to approve or disapprove the issuer's recommendation. Rather, the form of proxy should clearly provide four choices (1,2 or 3 years or abstain) as to the frequency vote.

Shareholder proposals. Rule 14a-8 provides an opportunity for eligible shareholders to include a proposal in an issuer's proxy materials for a vote at an annual or special meeting of shareholders. An issuer is generally required to include such proposal unless the proposal falls within one of the enumerated excludable matters set forth in the rule, or if the shareholder fails to comply with certain procedural requirements. Currently, Rule 14a-8(i)(10) permits exclusion of a shareholder proposal that has already been substantially implemented.

The proposed amendment to Rule 14a-8 would add a new note to Rule 14a-8(i)(10) to permit the exclusion of a shareholder proposal that would provide for say-on-pay votes or for future frequency say-on-pay votes in certain circumstances. Specifically, if an issuer has already adopted a policy on the frequency of say-on-pay votes that is consistent with the plurality of votes cast (*i.e.*, receiving the greatest number of votes) in the most recent advisory vote on

frequency, the issuer is permitted to exclude a shareholder proposal (i) on the approval of executive compensation or (ii) on the frequency of such vote.[14]

Proposed amendments to Forms 10-K and 10-Q. The SEC's proposals would also amend Forms 10-Q and 10-K to provide additional disclosure items[15] to reflect how often the issuer will conduct the shareholder advisory vote on executive compensation. Depending on when the meeting providing the frequency vote is held, an issuer will disclose its action in light of the results of the frequency vote in either new Item 5(c) to Part II of Form 10-Q (during the quarter in which the vote occurs) or in new Item 9B of Form 10-K (if the vote is held in the fourth quarter of the issuer's fiscal year).

Since the frequency vote is advisory and non-binding, the SEC is proposing this new disclosure so that an issuer will notify shareholders on a timely basis as to its determination on the frequency of future advisory votes on executive compensation and whether its decision will follow the results of the shareholder vote.

Preliminary proxy materials. The SEC's proposed amendments include an amendment to Rule 14a-6, the rule governing the preliminary filing of proxy statements in certain circumstances, to clarify that the inclusion of a solicitation for a vote on executive compensation or on the frequency of such vote **would not** trigger a preliminary filing.

TARP companies. Currently, issuers that receive financial assistance under TARP must conduct a separate annual shareholder vote to approve executive compensation until such issuer has repaid all outstanding indebtedness under TARP. New Section 14A would not impose any additional requirements on such companies to conduct a separate shareholder advisory vote on executive compensation. Further, the proposed amendments would provide an exemption for TARP companies from the frequency vote until the issuer has repaid all outstanding indebtedness under TARP.

* * *

Frequently Asked Questions

Q: If my company files proxy materials prior to January 21, 2011 for a shareholder meeting occurring after that date, are we required to provide the shareholder advisory votes on executive compensation and vote frequency in our proxy materials?

A: Yes. Any proxy statement, whether in definitive or preliminary form, for meetings taking place on or after January 21, 2011, regardless of when filed,

[14] Note that the issuer must actually provide a vote on frequency at least as often as required by Section 14A(a)(2) in order to exclude the proposal under proposed amendment to Rule 14a-8(i)(10). See our Q&A at the end of this Alert for a specific example.

[15] Note that a company is already required to disclose in Item 5.07 of Form 8-K the results of any shareholder votes for any meeting at which directors are elected and may, but is not required to, disclose how the results of the votes will affect its plans.

must include the separate shareholder resolutions for approval of executive compensation and for the frequency of such votes.

Q: Did the SEC specify language to be used or a particular form of resolution for the advisory votes to approve executive compensation or golden parachutes?

A: No. The SEC did not mandate any specific language or form of resolution to be used for say-on-pay. However, with respect to the advisory vote on executive compensation, the resolution must relate to all compensation disclosure under Item 402 of Regulation S-K.

Q. If our company held its first vote under the rules (Rule 14a-21(b)) and adopted a policy to provide for shareholder votes on executive compensation every 2 years based on the largest number of votes received, could we exclude a shareholder proposal seeking a different frequency vote? For example, every year?

A. Yes. A shareholder proposal in this instance could be excluded so long as the issuer seeks votes on executive compensation every two years and provides a vote on frequency at least every six years as required by Section 14A(a)(2).

Q. If our company provided the golden parachute disclosure required by Section 14A(b)(1) in an annual meeting proxy statement and a shareholder advisory vote was conducted on executive compensation, are we required to conduct a separate advisory vote with regard to that same compensation in our merger proxy?

A. No. Under proposed Rule 14a-21(c), a separate shareholder advisory vote to approve any agreements or understandings and compensation disclosed pursuant to new proposed Item 402(t) is not required if such agreements or understandings have already been subject to an advisory vote on executive compensation in accordance with proposed Rule 14a-21(a). If, however, the issuer has modified any of those arrangements or adopted new arrangements since the say-on-pay vote in the annual meeting proxy statement, a separate advisory vote with respect to the new or modified golden parachute arrangements would be required.

Q. Did the SEC provide any guidance with respect to companies holding meetings prior to the adoption and effectiveness of new rules?

A. Yes. Until it takes final action to implement Section 14A, the SEC will not object if issuers do not file preliminary proxy material if the only matters that would require the preliminary filing are the say-on-pay advisory vote and the frequency vote. In addition, the SEC will not object if the form of proxy for the frequency vote provides a means whereby the person solicited may specify, by boxes, a choice among 1, 2, or 3 years, or abstain.

To the extent proxy service providers are not able to reprogram their systems to enable shareholders to vote among four choices, the SEC will also not object if the form of proxy for the frequency vote provides a means to specify, by boxes, a choice among 1, 2 or 3 years, yet proxies are not voted on the matter if the person solicited did not select a choice provided.

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