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The SEC Issues Proposed Rules on Dodd-Frank's Executive Compensation Shareholder Approval Rules

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On October 18, the SEC issued proposed rules ("Proposed Rules") implementing the executive compensation and golden parachute shareholder approval requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Basically public companies must solicit a separate nonbinding shareholder vote on certain executive compensation matters in their proxy statements ("Proxies") for annual meetings taking place on or after January 21, 2011.

We encourage public companies to immediately consider two actions – first, joining us in the submission of comments to the SEC on the Proposed Rules and the Dodd-Frank Act's other executive compensation provisions. More on that appears at the end of our summary. Second, public companies should be carefully considering (1) how to refine their 2011 CD&As and tabular disclosures to defuse issues that could trigger shareholder or proxy advisory firm criticism, and (2) what, if any, changes to golden parachutes should be made in 2011 so as to secure shareholder approval.

Section 951 of the Dodd-Frank Act:

- Added new section 14A(a)(1) to the Securities Exchange Act of 1934 (the "Exchange Act"), thereby requiring that at least every three years, public companies conduct a shareholder vote along with their Proxies on a nonbinding resolution to approve executive compensation as disclosed in their Proxies pursuant to Item 402 of Regulation S-K (the "Say on Pay Resolution").
- Added new section 14A(a)(2), which requires that at least every six years, public companies submit to shareholder vote along with their Proxies a nonbinding resolution to determine whether the vote required by section 14A(a)(1) should occur every one, two, or three years (the "Vote Frequency Resolution").
- Added new section 14A(b)(1), which requires that, along with a Proxy for a shareholder meeting at which shareholders will be asked to approve an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all of the company's assets (a "Change in Control"), the company must
    - disclose in plain English all named executive officer ("NEO") compensation that is contingent on the Change in Control and that has not already been the subject of a Say on Pay Resolution ("CIC Payments"), and

- seek a separate nonbinding shareholder approval of those CIC Payments ("Golden Parachute Vote").

See our Public Companies Subject to Far-Reaching Corporate Governance Reforms Client Alert for additional background information.

Overview of Proposed Rules

The Say on Pay Resolution and the Vote Frequency Resolution must be put to a vote at the first annual or other meeting of shareholders that occurs after January 20, 2011 (regardless of when the Proxy statement for that meeting is filed). The Golden Parachute Vote, however, is required at the first meeting to approve a Change in Control that occurs after both (i) January 20, 2011 and (ii) the effective date of the SEC's final rules implementing the Dodd-Frank Act's Golden Parachute Vote requirements.

The Proposed Rules require that companies disclose in their Proxies that Say on Pay Resolutions, Vote Frequency Resolutions and Golden Parachute Votes (collectively, the "Executive Compensation Votes") are required by Section 14A of the Securities Exchange Act, and explain the general effect of each such vote (e.g., whether the vote is, in fact, nonbinding). The Proposed Rules also provide for a delayed effective date for the Say on Pay and Vote Frequency Resolutions for TARP fund recipients until the first shareholder meeting after of all TARP funds have been repaid, and for limited disclosure requirements for small reporting companies.

Highlights of the Proposed Rules for each of the three required Executive Compensation Votes follows:

Say on Pay Resolution

The Proposed Rules would appear as new Rule 14a-21(a), and would:

- Provide that inclusion of a Say on Pay Resolution will not require a Proxy to be filed in preliminary form.
- Clarify that neither director compensation nor the compensation policies and practices relating to risk-taking and risk management are subject to the Say on Pay Resolution requirements (although the SEC notes that they may be considered by the shareholders in deciding how to vote).
- Clarify that Golden Parachute arrangements are subject to the Say on Pay Resolution to the extent they are disclosed pursuant to Item 402(t) in Proxy.
- Clarify that there is no magic language or form of resolution for the Say on Pay Resolution.
- Clarify that, because the vote must be to approve NEO compensation "as disclosed" pursuant to Item 402 of Regulation S-K, it will not suffice merely to solicit approval of the company's compensation practices and procedures.
- Adjust the Proposed Rules for smaller reporting companies so that they relate to the scaled-back disclosures that they make concerning executive compensation.
- Reduce burdens associated with shareholder say on pay proposals by allowing a company to exclude them from its Proxy as long as the company implemented a vote frequency

policy that is consistent with the plurality of the votes cast for the most recent Vote Frequency Resolution.

Issuers will be required to disclose the outcome of their Say on Pay votes on a Form 8-K filed within four days after the shareholder meeting ends. The SEC has revised the disclosure requirements under Item 402(b)(1) of Regulation S-K to require that CD&As discuss how a company's compensation policies and practices have taken into account the results of Say on Pay votes. This requirement would not apply to smaller reporting companies.

Vote Frequency Resolution

The Proposed Rules:

- Clarify that the vote is *nonbinding*.
- Provide that inclusion of a Vote Frequency Resolution will not require a Proxy to be filed in preliminary form.
- Provide that that they are not applicable to TARP companies until they exit TARP restrictions.
- Require that shareholders be provided with four separate choices identified by separate boxes on the Proxy to vote for disclosure every one, two, or three years, or to abstain from voting.
- Clarify that the first vote requirement applies to the first shareholder meeting for which Item 402 of Regulation S-K disclosure is required after January 20, 2011
- Require that *in addition to satisfying their Form 8-K obligations*, companies disclose on their 10-Qs covering the period in which a Vote Frequency Resolution occurred (or 10-Ks, for votes occurring during the fourth fiscal quarter covered by the 10-Ks), their decision as to how frequently they will request shareholder votes on executive compensation for the next six years.
- Reduce burdens associated with shareholder vote frequency proposals by allowing a company to exclude shareholder proposals on vote frequency from its Proxy as long as the company has "implemented a vote frequency policy that is consistent with the plurality of the votes cast for the most recent Vote Frequency Resolution.

Note: The ability to exclude shareholder Say on Pay and Vote Frequency proposals from Proxies may be a compelling reason for many companies to implement a vote frequency policy consistent with the most recent Vote Frequency Resolution.

Golden Parachute Vote

The Proposed Rules require:

- That disclosure be made both in narrative form and tabular form pursuant to the following table:

Golden Parachute Compensation Name	Cash	Equity	Pension/ NQDC	Perquisites/ Benefits	Tax Reimbursement	Other	Total

- Footnote disclosure of the amount payable due to double-trigger arrangements, specifying the timeframe in which the termination must occur, and the amount payable under single-trigger arrangement.
- Separate tables for companies conducting a Golden Parachute Vote, with one for new or revised arrangements; the first table would require disclosure of all golden parachute arrangements and the second would require disclosure of only the new or revised arrangements.
- Narrative disclosure of all material factors relating to each golden parachute arrangement, including the payment triggers, whether the payments will or could be made in a lump sum or over time (and the duration of such payments), by whom the payments will be made, any material conditions to receipt of such payments (e.g., non-competes), the duration of such conditions and any provisions regarding waiver or breach of such conditions.
- Disclosure of benefits under group life, health, hospitalization or medical reimbursement plans that do *not* discriminate in scope, terms or operation, in favor of executive officers or directors of the company and that are generally available to all salaried employees.

Finally, the SEC explained that these disclosures apply not only to Change in Control transactions, but also to transactions associated with (i) registration statements on Forms S-4 and F-4 for mergers and similar transactions, (ii) going private transactions on Schedule 13E-3 and (iii) third party tender offers on Schedule TO and Schedule 14D-9 solicitation/recommendation statements.

SEC Comments

The SEC is soliciting comments on the Proposed Rules and other Dodd-Frank executive compensation provisions through November 18, 2010. We are currently working on submitting comments to the SEC with respect to several issues not covered in this Client Alert including the pay ratio and clawback provisions of the Dodd-Frank Act. In particular, those comments focus on

- Making the pay ratio test more precise and less onerous (for example, through requests for reliance periods, sampling of employee compensation, and other safe harbor mechanisms).

- Better articulating the scope and demands of the Dodd-Frank Act's mandatory clawback, which could be interpreted (wrongly, we believe) to have retroactive effect to compensation earned before the Dodd-Frank Act's enactment, and to require clawbacks of small amounts from current and former Section 16 reporting persons).

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