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Skadden

Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates

SEC Adopts Final Say-on-Pay Rules

The SEC recently adopted final rules to implement the provisions of Section 951 of the Dodd-Frank Act relating to three shareholder advisory votes – votes on executive compensation ("say-on-pay" votes); votes on whether future say-on-pay votes should take place every one, two or three years ("frequency" votes); and votes on merger-related compensation arrangements ("say-on-golden parachute" votes) – and additional "golden parachute" disclosure requirements. The final rules are substantially similar to the proposed rules.

Say-on-pay and frequency votes are required for all companies subject to the SEC's proxy rules, other than "smaller reporting companies," at a company's first annual meeting (or special meeting in lieu of an annual meeting) occurring on or after January 21, 2011.[1] Smaller reporting companies (generally, those with a public float below $75 million) will not be required to hold say-on-pay and frequency votes until their first annual meeting taking place on or after January 21, 2013. Say-on-golden parachute votes and the related golden parachute disclosure requirements apply to proxy statements and other transaction-related SEC filings initially filed on or after April 25, 2011.

Proxy Statement/Annual Meeting Action Items

As the 2011 proxy season rapidly approaches, companies should:

- Continue to analyze whether proxy advisory firms or major shareholders are likely to have concerns regarding the company's executive compensation program and, if so, try to engage major shareholders in a constructive dialogue regarding compensation matters;
- Consider enhancements to the company's Compensation Discussion and Analysis (CD&A), such as an executive summary or the use of graphics, and inclusion of a brief say-on-pay supporting statement to more effectively communicate to investors the company's commitment to "pay for performance" and positively influence say-on-pay voting decisions; and
- Consider the board's recommendation on the frequency vote and how best to articulate why that frequency is appropriate in light of the company's executive compensation practices.

A description of the key provisions of the SEC's final rules follows.

Say-on-Pay and Frequency Votes

Form of Resolutions. The SEC is not requiring any specific language or form of resolution for say-on-pay votes (which must take place at least once every three calendar years) or frequency votes (which must take place at least once every six calendar years). An instruction to the final rule, however, provides that a company's

1 Certain disclosure requirements relating to the say-on-pay and frequency votes (and described in this memorandum) will not be effective until 60 days after the rules are published in the *Federal Register.* Nevertheless, we expect that companies filing proxy statements prior to that time, as a practical matter, are likely to comply with the disclosure requirements.

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Stuart N. Alperin
New York
212.735.3920
stuart.alperin@skadden.com

Brian V. Breheny
Washington, D.C.
202.371.7180
brian.breheny@skadden.com

David J. Friedman
New York
212.735.2218
david.friedman@skadden.com

Marc S. Gerber
Washington, D.C.
202.371.7233
marc.gerber@skadden.com

Richard J. Grossman
New York
212.735.2116
richard.grossman@skadden.com

Neil M. Leff
New York
212.735.3269
neil.leff@skadden.com

Regina Olshan
New York
212.735.3963
regina.olshan@skadden.com

Joseph M. Yaffe
Palo Alto
650.470.4650
joseph.yaffe@skadden.com

* * *

Four Times Square, New York, NY 10036
Telephone: 212.735.3000

WWW.SKADDEN.COM

say-on-pay resolution must indicate that the advisory vote is to approve the compensation of the company's named executive officers, as disclosed pursuant to Item 402 of Regulation S-K. In addition, the instruction contains the following non-exclusive example of a resolution that would satisfy the rule:

> "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."

Proxy Statement Disclosure – This Year. A company must disclose in its proxy statement that the company is providing the say-on-pay and frequency votes pursuant to the Exchange Act (the advisory vote requirements were added to the Exchange Act by the Dodd-Frank Act) and briefly explain that the votes are non-binding. Although not required by the SEC rules, many companies to date have included brief supporting statements as to why shareholders should vote in favor of the company's executive compensation and recommended frequency for future say-on-pay votes. Also, some companies have included statements to the effect that the compensation committee and board of directors will give due consideration to the views expressed by shareholders in the advisory votes, although such statements are not required.

Proxy Statement Disclosure – Future Years. In future years, companies must disclose in their CD&A whether the company considered the results of the most recent say-on-pay vote in determining executive compensation policies and decisions and, if so, how that consideration has affected those policies and decisions.[2] In the final rule release, the SEC notes that while mandatory CD&A disclosure is limited to consideration of the results of the most recent say-on-pay vote, companies should address their consideration of the results of earlier say-on-pay votes if material to their compensation policies and decisions.

In addition, in future years, companies must disclose in the proxy statement the current frequency of say-on-pay votes and when the next say-on-pay vote will occur.

Frequency Votes. As proposed, the final rules require that proxy cards must provide four choices on frequency votes: one, two or three years and abstain. In the event that a company's proxy service provider is unable to change its systems in time to provide a proxy card with four choices, for any proxy materials filed for meetings to be held on or before December 31, 2011, the SEC will not object if a form of proxy provides a choice of one, two or three years, with proxy cards without a choice marked treated as abstentions.[3]

No Preliminary Proxy Statement. As proposed, the SEC added say-on-pay votes and frequency votes to the list of items that do not trigger the requirement to file preliminary proxy materials with the SEC.

Disclosure of Frequency Decision. The SEC had proposed that companies disclose their frequency decision on a Form 10-Q for the period in which the annual meeting was held. The final rules have been revised in response to comments that the proposal did not provide boards with sufficient time to make a frequency decision. As adopted, companies must disclose their frequency decision pursuant to Item 5.07 of Form 8-K, which may be done in an amendment to the initial Form 8-K disclosing the

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2 Although this requirement will not apply to the 2011 proxy statements for most companies (including companies that "voluntarily" provided shareholders with say-on-pay votes in 2010), it will apply to companies that under the TARP legislation were required to provide say-on-pay votes in 2010 and file their 2011 proxy statements on or after the effective date of this rule (60 days after publication in the *Federal Register*).

3 In response to comments, the SEC confirmed that, consistent with existing rules, companies may vote signed, uninstructed proxy cards in accordance with management's recommendation if the company includes a recommendation for the frequency vote in the proxy statement, provides an abstention choice on the proxy card and includes language in bold face type on the proxy card indicating how uninstructed shares will be voted. Most companies already include a form of this language on their proxy cards.

voting results of the annual meeting. The Form 8-K amendment is due by the earlier of (i) 150 calendar days after the date of the meeting at which the vote occurred or (ii) 60 calendar days prior to the deadline for the submission of shareholder proposals under Rule 14a-8 for the subsequent annual meeting.

Impact on Shareholder Proposals. If a single frequency choice (*i.e.*, one, two or three years) receives the support of a majority of the votes cast, and the company adopts a policy on the frequency of say-on-pay votes that is consistent with that choice, the company may exclude as "substantially implemented" shareholder proposals that provide a say-on-pay vote, seek future say-on-pay votes or relate to the frequency of say-on-pay votes. This interpretation of "substantially implemented" will not be available if none of the frequency choices receives a majority of votes cast. This is a change from the proposed rule, which contained a plurality standard, and may result in some companies that do not adopt annual say-on-pay votes facing annual say-on-pay or frequency shareholder proposals. In addition, the final rule release states that no-action requests to exclude shareholder proposals seeking advisory votes "on different aspects of executive compensation" will be evaluated by the SEC staff on a case-by-case basis. In any event, it is likely that companies will continue to receive a variety of shareholder proposals relating to executive compensation that are not subsumed by say-on-pay votes.

Frequency Votes – Recent Experience. To date, only a small handful of companies have held 2011 annual meetings and reported voting results on frequency votes. Although extrapolation from such a small sample size carries the risk of not taking into account company-specific facts and circumstances, it may still be noteworthy that five out of five S&P 500 companies that recommended triennial votes to their shareholders saw annual voting receive majority support, by generally similar margins: Air Products (60.5% in favor of annual votes); Costco (52.6% in favor of annual votes); Jacobs Engineering Group (68.1% in favor of annual votes); Johnson Controls (58.6% in favor of annual votes); and Monsanto (62.5% in favor of annual votes). Costco and Monsanto quickly announced that they would hold annual say-on-pay votes.

The number of companies holding votes and disclosing results will grow over the coming weeks and we will continue to monitor trends in voting results. Companies continuing to consider their frequency recommendation may wish to call one of the Skadden attorneys listed on page 1 or their regular Skadden contact for updated data.

Say-on-Golden Parachute Votes and Related Disclosure

General Disclosure Requirements. New Item 402(t) of Regulation S-K requires tabular and narrative disclosure regarding "golden parachute" arrangements for each named executive officer of the acquiring company and the target company. The disclosure covers any agreement or understanding (whether written or unwritten) between such named executive officer and the acquiring company or the target company concerning any type of compensation (whether present, deferred or contingent) that is based on or otherwise relates to the merger or similar transaction. In response to comments, the SEC clarified that the disclosure only covers compensation arrangements relating to the subject transaction and does not require disclosure of previously vested equity awards.

The Item 402(t) disclosure is required in a variety of disclosure documents relating to business combination transactions, so that the disclosure will be required regardless of the form of the transaction. Also, the Item 402(t) disclosure is required in an acquiring company's proxy statement seeking shareholder approval for the issuance of shares to effectuate a merger or similar transaction. In response to comments, the final rules do not require Item 402(t) disclosure by bidders in third-party tender offers unless the transaction also is a Rule 13e-3 going-private transaction. The Item 402(t) disclosure would be included, however, in the target company's Schedule 14D-9 filed in response to the third-party tender offer.

Item 402(t) disclosure is not required to be included in an annual meeting proxy statement and, as discussed below, we expect few (if any) companies voluntarily to include the disclosure in annual meeting proxy statements (beyond the disclosure already required by Item 402(j) relating to potential payments upon a change-in-control).

Tabular Disclosure. The golden parachute compensation table presents the individual elements of merger-related compensation − cash severance; value of accelerated equity awards; pension and deferred compensation benefit enhancements; perquisites and health and welfare benefits; tax gross-ups; and any other elements of compensation − and the total for each named executive officer. The table requires footnote identification of amounts attributable to "single trigger" arrangements and amounts attributable to "double trigger" arrangements. The table does not require disclosure of compensation from bona fide post-transaction employment agreements entered into as part of the transaction (although disclosure of those agreements would continue to be required under other disclosure requirements).

Narrative Disclosure. The narrative disclosure must describe any material conditions or obligations regarding the payment, such as non-compete or non-solicitation obligations, specific circumstances triggering payments, duration of payments and other material provisions of the agreement or arrangement providing for the merger-related compensation.

Say-on-Golden Parachute Vote. The say-on-golden parachute vote is required when shareholders are being asked to approve a merger or similar transaction, unless the compensation arrangements between the soliciting entity and its named executive officers were the subject of a prior say-on-pay vote. The vote is an advisory vote that is separate from the vote to approve the transaction and will not factor into whether the transaction has obtained the requisite shareholder approval.

Although disclosure of golden parachute agreements or understandings between an acquiring company and the named executive officers of a soliciting target company are subject to disclosure under Item 402(t), these arrangements are not subject to the say-on-golden parachute vote. Thus, if a company's Item 402(t) disclosure includes arrangements beyond those that are subject to the say-on-golden parachute vote, the company must provide a second table containing information for only those arrangements that are subject to the say-on-golden parachute vote.

The golden parachute arrangements will be viewed as having been subject to a prior say-on-pay vote only if a company voluntarily has included the Item 402(t) disclosure in its annual meeting proxy statement (in which case the disclosure is part of the executive compensation disclosure subject to a say-on-pay vote) and the terms of those arrangements have not been subsequently modified. Any new or modified arrangements require a say-on-golden parachute vote with respect to the new arrangements and the revised terms of arrangements previously subject to a say-on-pay vote. The SEC indicated in the final rule release that an update to the Item 402(t) tabular disclosure to reflect changes in value due to changes in the company's stock price or changes resulting only in a reduction of the value of total compensation payable would not be modifications requiring a say-on-golden parachute vote. On the other hand, the SEC indicated that the addition of a new named executive officer, additional grants of equity compensation (even in the ordinary course) and increases in salary are modifications that would require a say-on-golden parachute vote. In the event of a vote on new arrangements or revised terms, a company would be required to provide two tables under Item 402(t) – one table disclosing all golden parachute compensation and a second table reflecting only the new arrangements or revised terms subject to the say-on-golden parachute vote.

In light of the many circumstances that would constitute new or modified golden parachute arrangements and thus would trigger the requirement to hold a say-on-golden parachute vote, it appears that there is little benefit to including the Item 402(t) disclosure in an annual meeting proxy statement.

Moreover, ISS has indicated, in its policy updates for 2011, that if a company voluntarily includes Item 402(t) disclosure in an annual meeting proxy statement, ISS will give greater weight to its evaluation of the merger-related compensation arrangements in assessing executive compensation for purposes of its say-on-pay voting recommendation. Accordingly, we expect few (if any) companies to include Item 402(t) disclosure in an annual meeting proxy statement.

Other Dodd-Frank Compensation-Related Rulemaking

The SEC has updated the Dodd-Frank implementation schedule posted on its website. As updated, rules requiring disclosure of pay-for-performance, the pay ratio of the CEO to median employee compensation and hedging policies, as well as rules on clawback policies, are expected to be proposed between August and December 2011 (rather than between April and July 2011). As a result of this change in timing, it is possible that some or all of these rules may not be effective for the 2012 proxy season. The SEC is still planning to propose rules regarding the independence of compensation committees and their advisors by the end of March 2011, with final rules adopted by July 2011.