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SEC Adopts Final Say-on-Pay Rules

On January 25, 2011, the Securities and Exchange Commission (SEC) adopted final rules to implement the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) with respect to shareholder approval of executive compensation arrangements and disclosure and shareholder approval of golden parachute compensation arrangements. Under Dodd-Frank and the SEC's rules, public companies are required to provide their shareholders:

- a separate advisory vote to approve the compensation of their named executive officers, at least once every three calendar years (a Say-on-Pay vote);
- a separate advisory vote with respect to whether the Say-on-Pay vote should occur every one, two or three years, at least once every six calendar years (a Say-on-Frequency vote); and
- specific disclosures with respect to golden parachute compensation arrangements and a separate advisory vote to approve certain golden parachute compensation arrangements (a Say-on-Parachute vote) in connection with specified significant corporate transactions.

The final rules closely track rules proposed on October 18, 2010, but with certain modifications. Although the final rules are not effective until 60 days after their publication in the Federal Register, Dodd-Frank requires public companies to provide Say-on-Pay and Say-on-Frequency votes at their first annual or other shareholders meeting occurring on or after January 21,

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Contacts:

Cipriano S. Beredo
+1.216.479.8280

Daniel G. Berick
+1.216.479.8374

Julia M. Tosi
+1.216.479.8351

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2011 for which compensation disclosure must be provided, regardless of the status of the SEC rules. Companies preparing proxy materials for meetings at which Say-on-Pay and Say-on-Frequency votes will be required but to which the SEC's rules will not yet apply should look to the final rules in preparing their Say-on-Pay and Say-on-Frequency proposals and should consider the transition guidance provided by the SEC in the Adopting Release and further discussed below.

The SEC's Adopting Release is available here. Chairman Schapiro's remarks at the open meeting at which the rules were adopted are available here, and dissenting remarks made by Commissioners Casey and Paredes, which focused on the rules' treatment of smaller reporting companies and newly public companies and on the standard for excluding future shareholder Say-on-Pay proposals from company proxy materials, are available here and here. Certain noteworthy aspects of the SEC's final rules and ways in which they differ from the proposed rules are summarized below.

Say-on-Pay and Say-on-Frequency Votes

The SEC's final rules clarify that Say-on-Pay and Say-on-Frequency votes will be required only when proxies are solicited for an annual or special shareholders meeting at which directors will be elected. A company need not file a preliminary proxy statement as a result of including Say-on-Pay or Say-on-Frequency proposals or any other shareholder advisory vote on executive compensation in a proxy statement. The rules do not require companies to use a specific form of resolution for either the Say-on-Pay proposal or the Say-on-Frequency proposal, but the Say-on-Pay resolution must indicate that the vote is to approve the compensation of the company's named executive officers as disclosed pursuant to Item 402 of Regulation S-K, and the final rules provide a non-exclusive example of a compliant resolution. The Say-on-Pay vote does not cover director compensation or disclosures that relate to risk management and risk-taking incentives as they relate to employee compensation generally, although risk considerations discussed in a company's Compensation Discussion and Analysis (CD&A) as material to an understanding of named executive officer compensation would be considered in connection with the shareholder vote.

When required to provide a Say-on-Pay or Say-on-Frequency vote, a company must briefly explain the general effect of the vote, such as whether the vote is non-binding. When applicable, the company must disclose the current frequency of the Say-on-Pay vote,

as determined by the board following a Say-on-Frequency vote, and when the next Say-on-Pay vote will occur. Companies are not expected to include this disclosure in their proxy materials for the meeting at which the first Say-on-Pay and Say-on-Frequency votes will occur. Although a company is not required to provide a supporting statement for either proposal, a company should consider whether including a supporting statement in the proposals and/or an executive summary in the CD&A, and otherwise enhancing its CD&A disclosure, would facilitate shareholders' consideration of the Say-on-Pay and Say-on-Frequency proposals.

The rules do not require a company to include a recommendation on either of these proposals, though we expect that most boards will opt to provide recommendations. When providing a recommendation with respect to the Say-on-Frequency vote, however, the company must make clear that there are four choices (every one, two or three years, or to abstain) and that shareholders are not voting to approve or disapprove the company's recommendation. As noted in the Adopting Release, a proxy may vote uninstructed shares in accordance with management's recommendation on the Say-on-Frequency vote only if the company includes a recommendation for the frequency of Say-on-Pay votes in the proxy statement, permits abstention from the Say-on-Frequency vote on the proxy card and specifies in bold on the proxy card how uninstructed shares will be voted.

Votes Required in Connection with Say-on-Pay and Say-on-Frequency Proposals and Interaction With Ability to Exclude Future Shareholder Proposals From Company Proxy Materials Under Exchange Act Rule 14a-8

The rules do not prescribe a standard for determining whether a Say-on-Pay proposal has been approved or for determining which frequency has been "adopted" by the shareholders in connection with a Say-on-Frequency vote. As such, the general approval standard under state law and a company's governing documents should apply to these proposals. In light of the advisory nature of these votes, however, companies and shareholders should bear in mind that the results are not binding on the company or the board, that a company may or may not follow the shareholders' recommendation and that a company may respond even if a proposal does not receive the required level of votes to be "approved" under the applicable voting standard.

The rules permit a company to exclude, in certain

limited circumstances, a subsequent shareholder proposal made in accordance with Exchange Act Rule 14a-8 that seeks a vote on the same matters as the Say-on-Pay and Say-on-Frequency votes. In order to qualify for the exception, one of the frequencies (one, two or three years) must have received the support of a majority of the votes cast in a company's most recent Say-on-Frequency vote, and the company must have adopted a policy on the frequency of Say-on-Pay votes that is consistent with the majority's choice. The availability of the exception under the final rule is more limited than it would have been under the proposed rule, which would have permitted exclusion where the company had implemented a frequency that received a plurality of the votes cast. Abstentions do not count as votes cast for this analysis, and the rules' standard for determining the availability of the Rule 14a-8 exemption may not be the same as the standard for approval under state law or the company's governing documents.

Disclosure Regarding Consideration and Implementation of Say-on-Pay and Say-on-Frequency Votes

A company is required to discuss in its CD&A whether and, if so, how it has considered the results of the most recent Say-on-Pay vote in determining its compensation policies and decisions and how that consideration has affected its compensation policies and decisions. The final rule on this point represented a change from the proposed rule, under which the mandatory CD&A discussion would not have been limited to the consideration of the most recent vote. Notwithstanding the text of the final rule, in determining whether to discuss responses to more than the most recent Say-on-Pay vote, companies should consider the principles-based nature of the CD&A and the SEC's comment in the Adopting Release that it believes that the consideration of earlier Say-on-Pay votes should be addressed in the CD&A to the extent it is material to an understanding of a company's compensation policies and decisions.

A company must disclose how frequently it will hold Say-on-Pay votes during the period between required Say-on-Frequency votes. This disclosure is required on Form 8-K, by amendment to the prior report(s) on Form 8-K providing the results of the Say-on-Frequency vote, by the earlier of 60 calendar days before the Rule 14a-8 deadline for the next annual meeting or 150 calendar days after the meeting at which the Say-on-Frequency vote occurred. A failure to timely file the Form 8-K with the company's frequency determination will result in a loss of Form S-3 eligibility. The proposed rules would have required this disclosure earlier and in the Form 10-

Q or Form 10-K for the period in which the meeting occurred, but the SEC provided companies additional time to make their frequency decisions in response to commenters' concerns that disclosure in the Form 10-Q or Form 10-K would not provide sufficient time to fully consider the results of the vote. In setting the deadline, the SEC balanced companies' need for additional time to decide with the need to ensure that the decision is disclosed to the shareholders in enough time for a shareholder to consider whether to make a proposal under Rule 14a-8 for the next meeting.

Say-on-Pay and Say-on-Frequency for TARP Companies

Because companies with outstanding indebtedness under the Troubled Asset Relief Program (TARP) already are required to conduct a separate annual shareholder vote to approve executive compensation that is essentially the same vote required under Dodd-Frank, the final rules include certain accommodations for companies with outstanding indebtedness under TARP with respect to the Dodd-Frank Say-on-Pay and Say-on-Frequency votes. In particular, companies that conduct annual shareholder votes on executive compensation pursuant to the Emergency Economic Stabilization Act of 2008 (EESA) are not required to conduct a Say-on-Pay vote under the Dodd-Frank rules until the first annual meeting after the company has repaid all outstanding indebtedness under TARP. In addition, companies with outstanding indebtedness under TARP are exempt from the requirement to provide a Say-on-Frequency vote until the first annual meeting of shareholders after they have repaid all outstanding TARP indebtedness.

Disclosure of Golden Parachute Arrangements and Say-on-Parachute Vote

The rules prescribe the specific disclosures required in proxy and consent solicitations relating to acquisitions, mergers, consolidations or proposed sales or other dispositions of all or substantially all assets under Dodd-Frank with respect to any agreement or understanding between the named executive officers of the acquiring and target companies and the acquiring or target company concerning compensation that is based on or otherwise relates to the transaction (a golden parachute arrangement). The rules also require the same level of golden parachute disclosure in connection with filings for other significant corporate transactions (e.g., going private transactions and tender offers). In addition, the rules implement the Dodd-Frank requirement that a Say-on-Parachute vote be provided with respect to

golden parachute arrangements in connection with an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all assets. The Say-on-Parachute vote need not cover arrangements between the soliciting target company's named executive officers and the acquiring company, even though disclosure of those arrangements is required.

The disclosure required under the new rules in the context of significant corporate transactions differs from the disclosure required under the pre-existing post-employment executive compensation disclosure rules that apply in the context of an annual meeting proxy statement. Companies are not required to provide the new transactional golden parachute disclosures in their annual meeting proxy statements but may continue to provide disclosure in accordance with the post-employment compensation rules applicable in that context. There is an exception to the requirement to include in the transaction proxy statement a separate shareholder vote on the golden parachute arrangements for arrangements that have been subject to a prior Say-on-Pay vote, but in order to take advantage of that exception, the executive compensation disclosure included in the prior annual meeting proxy statement must have complied with the new rules' transactional level of golden parachute disclosure (i.e., not just the traditional annual post-employment compensation disclosure requirements), and the arrangements previously disclosed and subject to a vote must not have been modified since the earlier vote.

Smaller Reporting Companies

The final rules provide smaller reporting companies a temporary exemption from (and delayed compliance with) the Say-on-Pay and Say-on-Frequency requirements. Smaller reporting companies will not be required to conduct either a Say-on-Pay vote or a Say-on-Frequency vote until their first shareholders meeting held on or after January 21, 2013. Once smaller reporting companies are required to provide a Say-on-Pay vote, the final Say-on-Pay rules will not change the pre-existing scaled compensation disclosure requirements for smaller reporting companies in their annual meeting proxy statements. For example, a smaller reporting company will not be required to provide a CD&A in order to comply with the Say-on-Pay rules.

The SEC did not apply the temporary exemption for smaller reporting companies to the requirement to provide a Say-on-Parachute vote in connection with mergers or other extraordinary transactions, and

smaller reporting companies will be required to provide Say-on-Parachute votes on the same implementation schedule as other public companies. In addition, although smaller reporting companies are not required to quantify post-employment compensation in their annual meeting proxy statements, their proxy or consent solicitations with respect to mergers or other extraordinary transactions will be required to quantify golden parachute arrangements in accordance with the new rules.

Transition Guidance

Because certain companies may be required to file proxy statements in which they must provide Say-on-Pay and Say-on-Frequency votes under Dodd-Frank before the technical effective date of the final SEC rules, the SEC provided certain transition guidance in the Adopting Release. Under the transition guidance, the SEC will not object if, before its rules are effective:

- companies do not file proxy materials in preliminary form if the only matters that would require a preliminary filing are the Dodd-Frank Say-on-Pay and Say-on-Frequency votes;
- the proxy card for a Say-on-Frequency vote includes the options that will be required upon the effectiveness of the final rules (a choice of one, two or three years, or abstention);
- a company with outstanding indebtedness under TARP does not include a Dodd-Frank Say-on-Pay or Say-on-Frequency resolution in its annual meeting proxy statement, as long as it fully complies with its say-on-pay voting obligations under EESA;
- a smaller reporting company does not include a Say-on-Pay or Say-on-Frequency resolution in its annual meeting proxy statement.

In addition, to accommodate a potential short-term difficulty in re-programming proxy service provider voting systems to enable shareholders to choose from among four options, the SEC has indicated that it will not object if, for the Say-on-Frequency vote for meetings held on or before December 31, 2011, the proxy card provides only the options of every one, two or three years, with no ability to abstain, as long as there is no discretionary authority to vote proxies on the Say-on-Frequency proposal where none of the three options is selected.

Additional Information

For more information about the SEC's rules regarding

shareholder approval of executive compensation and golden parachute compensation, please contact your principal Squire Sanders lawyer or any of the lawyers listed in this Alert.