WOHL & FRUCHTER LLP

FEBRUARY 2011

Legislative and Regulatory Update

HIGHLIGHTS

- The Dodd-Frank Act's say-on-pay shareholder advisory vote went effective in January 2011
- SEC final rules mandate enhanced golden parachute disclosures and will likely draw more attention to insider M&A payouts

CORPORATE GOVERNANCE

Say-on-Pay — SEC Final Rules Issued; Shareholder Advisory Vote on Pay Becomes Effective

The Dodd-Frank Act's[1] say-on-pay mandate became effective for shareholder meetings held starting January 21, 2011, and the SEC has issued final implementing rules.

Summary

As required by Dodd-Frank (which added new Section 14A to the Securities Exchange Act) and as implemented by the SEC's final rules (primarily, new Rule 14a-21), public companies are obligated to give shareholders non-binding votes on three issues:

- Whether to approve the executive compensation regime set forth in the company's annual proxy;
- How frequently the say-on-pay advisory vote should be held; and
- Whether to approve golden parachute payments to senior executives.

The rules call for a simple, up-or-down vote on the company's compensation plan as set forth in its compensation discussion and analysis (CD&A) disclosure,[2] and require that the approval vote be held every one, two or three years. The rules also require that the "say-on-frequency" vote be held at least once every six years, and that the ballot allow shareholders to select whether to vote on pay every one, two or three years. The final decision on frequency – like the underlying decision on pay – is up to the board.

To implement the "say-on-golden parachute" requirement, the SEC amended the CD&A disclosure rules to significantly expand on the existing change-in-control and employment termination disclosures required in the annual proxy.[3] The expanded disclosures may be included either in the annual proxy, or in the disclosure documents issued in connection with the event triggering the golden parachute payment. While the statute requires the new disclosures only with respect to "an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all the assets of an issuer," the final rules mandate the expanded disclosures

1 Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

2 The CD&A rules are codified as Item 402 of Regulation S-K, 17 C.F.R. § 229.402. There is no required form for the say-on-pay resolution; the SEC instructions propose: "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."

3 The final rules add new Item 402(t); the existing disclosures are set forth in Item 402(j).

CORPORATE GOVERNANCE

SEC Final Rules Issued; Shareholder Advisory Vote on Pay Becomes Effective

for any kind of sale transaction – including a tender or exchange offer.[4]

Commentary

The requirement of a separate vote and enhanced disclosures will likely draw more attention to potential insider conflicts resulting from golden parachute payments in M&A transactions. The utility of the enhanced disclosure rules, however, is limited by their omission of the type of arrangement that is often the most significant for senior management of the target – post-transaction employment agreements. The SEC consciously excluded such agreements on the grounds that the statute was not intended to reach post-sale compensation paid in the ordinary course,[5] but this omission allows circumvention of the required disclosure by structuring change-in-control payments as guaranteed post-employment compensation.

> *The final rules' exclusion of post-transaction employment agreements from the scope of golden parachute disclosure creates a significant loophole because change-in-control payments can be structured as guaranteed post-employment pay.*

With respect to the general say-on-pay vote, we have previously expressed the concern that such votes do not well-serve shareholders.[6] Prior experience with shareholder votes on equity-based compensation suggest that pay will be routinely approved; shareholders simply do not have resources or inclination to provide regular oversight of portfolio companies, and they could not if they wanted to: CD&A disclosure is – by design – limited in crucial respects to avoid forcing companies to disclose information that could be useful to competitors, such as performance targets.

More fundamentally, we are concerned that the shareholder vote diminishes the board's accountability. While new Exchange Act Section 14A(c) explicitly states that the shareholder vote "may not be construed . . . to create or imply any change to the fiduciary duties" of the board, it leaves open the possibility that the vote could be construed by a court as shareholder ratification of the compensation award. Apart from its potential legal significance, the vote constitutes an implied imprimatur by shareholders that we believe they are ill-equipped to provide.

---

4 Securities Exchange Act § 14A(b)(1), 15 U.S.C. § 78n-1.

5 Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. 6010, 6025 (Feb. 2, 2011).

6 Edward Labaton & Ethan Wohl, *Selective "Say-on-Pay" the Best Remedy,* Exec. Counsel, Nov./Dec. 2008, at 18.