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## The SEC's Final "Say": SEC Adopts Final Say On Pay and Related Shareholder Advisory Vote Regulations

At its open meeting on January 25, 2011, the Securities and Exchange Commission adopted final rules to implement the say on pay, say on pay frequency, and say on golden parachutes shareholder advisory votes required under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").<sup>1</sup> This memorandum summarizes the key provisions of the final regulations (the "Regulations"),<sup>2</sup> which in large part adopt the regulations as proposed on October 18, 2010.<sup>3</sup>

### 1. Say on Pay – Rule 14a-21(a)

Rule 14a-21(a) requires U.S. public issuers<sup>4</sup> to include in their proxy statements, not less frequently than once every three calendar years, a separate shareholder advisory vote (a "Say on Pay Vote") to approve the compensation of the issuer's named executive officers ("NEOs").<sup>5</sup> The Say on Pay Vote is required only when proxies are solicited for an annual or other meeting of shareholders at which directors will be elected, commencing with the first such meeting occurring on or after January 21, 2011.<sup>6</sup>

<sup>1</sup> SEC Rel No. 33-9178 (Jan. 25, 2011); 17 Fed. Reg. 6010 (February 2, 2011) (to be codified at 17 CFR Parts 229, 240, and 249). The text of the release is available at <http://www.gpo.gov/fdsys/pkg/FR-2011-02-02/pdf/2011-1971.pdf>. Section 951 of the Dodd-Frank Act amended the Securities Exchange Act of 1934, as amended (the "Exchange Act") by adding new Section 14A.

<sup>2</sup> The Regulations include some modifications and special transition rules applicable to smaller reporting companies, which are outside the scope of this memorandum.

<sup>3</sup> SEC Rel No. 33-9153 (Oct. 18, 2010). The text of the release is available at <http://www.sec.gov/rules/proposed/2010/33-9153.pdf>. Appendix A of this memorandum summarizes the material differences between the Regulations and the proposed regulations.

<sup>4</sup> Foreign private issuers, as defined in Rule 3b-4(c), are exempt from the say on pay, say on pay frequency and say on golden parachutes requirements of the Dodd-Frank Act.

<sup>5</sup> Section 951 of the Dodd-Frank Act expressly provides that the Say on Pay Vote is non-binding and is not intended to overrule any decision of the issuer or its board of directors, or create or imply any change or addition to the fiduciary duties of the board or the issuer.

<sup>6</sup> This rule applies even if the proxy statement for such meeting was filed prior to that date.

- Form of Resolution
  - The Regulations do not prescribe a form of resolution or specify language to be included in issuers' proxy statements. An instruction to Rule 14a-21(a) states that the resolution must indicate that the Say on Pay Vote "is to approve the compensation of the registrant's named executive officers as disclosed pursuant to Item 402 of Regulation S-K," echoing the statutory language from Section 14A(a)(1). The instruction also includes a non-exclusive example of a proposal.<sup>7</sup>
  - All compensation of the issuer's NEOs as disclosed pursuant to Item 402, which includes the Compensation Discussion and Analysis (the "CD&A"), the compensation tables and all other narrative disclosure required by Item 402, is subject to the Say on Pay Vote.
  - Directors' compensation disclosed pursuant to Item 402(k) is not subject to the Say on Pay Vote.
  - Disclosure about the issuer's policies and practices as they relate to risk management and risk-taking incentives is not subject to the Say on Pay Vote to the extent it relates to the issuer's compensation for employees generally. The instruction to Rule 14a-21 notes, however, that to the extent that risk considerations are a material aspect of the issuer's compensation policies for NEOs, those considerations must be discussed as part of the CD&A required by Item 402(b), and could therefore be considered by shareholders when voting on the compensation of NEOs.
  - If the issuer voluntarily includes Golden Parachute disclosure pursuant to Item 402(t) (discussed below) in the annual proxy statement, that disclosure would also be subject to the Say on Pay Vote.
- New Required Disclosure
  - The Regulations amend Item 402(b) to require that, in the first proxy statement following an issuer's initial Say on Pay Vote, the CD&A discuss whether the issuer considered the results of the most recent Say on Pay Vote required by Section 14A (and, for an issuer subject to the Troubled Asset Relief Program ("TARP"), Rule 14a-20) in determining its compensation policies and decisions, and if so, how consideration of the vote affected the issuer's final decisions.

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<sup>7</sup> "RESOLVED, that the compensation paid to the issuer'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."

- After seeking comments on the topic, the Regulations clarify that issuers need only address the impact of the most recent Say on Pay Vote, rather than all prior Say on Pay Votes. However, the SEC release adopting the Regulations (the “Release”) states that issuers’ disclosure should address their consideration of the results of earlier Say on Pay Votes to the extent those results were material to decisions relating to compensation of their NEOs.
- For a discussion of new Item 24 of Schedule 14A, which requires certain disclosure in proxy statements regarding the effect of a Say on Pay Vote and a Say When on Pay Vote, see page 16 below.
- Application to TARP Recipients
  - Issuers subject to TARP and the annual shareholder advisory vote on executive compensation required by Rule 14a-20 need not provide an additional Say on Pay Vote to meet the requirements of Rule 14a-21(a).
  - An issuer that repays all outstanding indebtedness under TARP will be required to include a separate shareholder Say on Pay Vote pursuant to Rule 14a-21(a) for its first annual meeting or other meeting of shareholders at which directors are to be elected that occurs after such repayment.
- Technical Issues
  - The Say on Pay Vote requirement does not include an exception for controlled companies.
  - The Regulations amend Exchange Act Rule 14a-6 to add Say on Pay Votes to the list of items that do not trigger the requirement to file a preliminary proxy. This is consistent with the transitional guidance included in the proposed regulations.
  - As required by the Dodd-Frank Act, the national securities exchanges have changed their rules to prohibit broker discretionary voting of uninstructed shares in Say on Pay Votes.<sup>8</sup>

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<sup>8</sup> See NYSE Rule 452, amended as of September 9, 2010 and NASDAQ Rule 2251, amended September 21, 2010. Because brokers often vote uninstructed shares in accordance with management recommendations, this required rule change likely contributed to the first failed Say on Pay Vote, which came within the first week of annual shareholder meetings subject to the requirements at the January 27, 2011 meeting of the shareholders of Jacobs Engineering Group Inc.

- Issues to Consider
  - Given the heightened focus on executive compensation, the CD&A is becoming a key communication tool. A premium should be placed on concise and clear disclosure, particularly around the correlation between pay and performance, and issuers should avoid excessive length and obfuscating legalese. Executive summaries can be used to highlight the most important points in the CD&A.<sup>9</sup> Issuers should use graphs and tables to make their disclosure more accessible. More legalistic disclosures (e.g., equity incentive policies and tax considerations), while important, should not detract from the key messages and analysis of compensation decisions.
  - Issuers should review the voting guidelines of significant shareholders regarding executive compensation and consider more vigorous shareholder outreach to anticipate reactions to pay policies and forestall negative votes. Ideally, such outreach should precede the proxy season and be part of an ongoing company program of investor engagement.
    - Institutional Shareholder Services (“ISS”) has noted that, if concerns raised by an issuer’s shareholders through a Say on Pay Vote are not adequately addressed in the subsequent year, it may recommend withhold/against votes on the re-election of members of the compensation committee. This raises practical issues discussed further below, including the difficulties issuers may face in determining which aspects of their compensation programs may have provoked a negative vote. The recent trend toward “one size fits all” policies, at least partly driven by proxy advisory firms, may ignore rational and persuasive business reasons for adopting particular features of compensation programs or arrangements. Meaningful engagement with investors may be helpful in countering the positions taken by proxy advisory firms.
  - The requirement to disclose in the CD&A the effect of the most recent Say on Pay Vote forces issuers to consider whether and how to react to the Say on Pay Vote. This will be challenging since the Say on Pay Vote provides undifferentiated guidance about the entirety of the pay disclosure for all NEOs. We are concerned that the requirement will lead to relatively boilerplate disclosure.
    - After its first Say on Pay Vote, an issuer who receives a “no” vote may have few choices but to look to the voting policies of the principal proxy

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<sup>9</sup> Some issuers have also revised their CD&As to highlight those compensation practices they employ that are widely regarded as “best practices.” Though this approach may have benefits in helping shareholders to focus on the positive elements of a compensation program, consideration should be given to the potential limitations they place on an issuer’s flexibility to alter these practices in the future.

advisory firms for guidance, magnifying the role those firms now play in driving public company governance.<sup>10</sup>

- The SEC has stated that the Regulations do not preclude more specific advisory votes on certain aspects of an issuer’s NEO compensation.<sup>11</sup>
- With limited guidance provided in the Regulations, issuers will be confronted with the question of what information, if any, should be included in the supporting statement for the Say on Pay Vote resolution. Some issuers have reiterated highlights of their compensation policies, philosophy and objectives, including in some cases, summaries of significant compensation decisions. While the level of appropriate disclosure will depend on an issuer’s circumstances, we generally recommend a simpler approach that provides the required background on the vote (as discussed below), including a cross-reference to the CD&A, and a very short supporting statement.

## 2. Say When on Pay – Rule 14a-21(b)

Rule 14a-21(b) requires issuers to provide a separate shareholder advisory vote in the first proxy statement containing a Say on Pay Vote, and at least once every six calendar years thereafter, to determine whether the Say on Pay Vote will occur every one, two or three years (the “Say When on Pay Vote”). Like the Say on Pay Vote, the Say When on Pay Vote is a non-binding advisory vote, and is to be included in proxy statements for annual or other meetings at which directors are elected.

- Form of Resolution and Voting Uninstructed Ballots
  - The Regulations do not prescribe a form of resolution or specify language to be included in issuers’ proxy statements.
  - The proxy card must include four voting choices: one, two or three years, or abstention.<sup>12</sup>

<sup>10</sup> In her prepared remarks delivered during the Jan. 25, 2011 open meeting, Commissioner Casey expressed concern with the growing influence of proxy advisory firms, and, in particular, ISS. See remarks available at <http://www.sec.gov/news/speech/2011/spch012511klc-2-3.htm>.

<sup>11</sup> This issue of specificity in the vote was spotlighted in a recent SEC no-action letter. In a rare move, the SEC recently reversed its position on a previous no-action ruling which had allowed Navistar International to exclude a shareholder proposal seeking to adopt a policy of obtaining shareholder approval for certain future severance agreements, on the basis that the company had “substantially implemented” the proposal with its Say on Pay Vote. In its subsequent letter dated January 4, 2011, the SEC stated that upon reconsideration, because the proposal sought approval of future agreements not included in the company’s current disclosure, it could not be excluded under Rule 14a-8(i)(10). The original and subsequent no-action letters are available at <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2010/teamstersgeneral120810-14a8.pdf> and <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2011/teamstersgeneralrecon010411-14a8.pdf>.

- Management may make a voting recommendation, and the SEC seems to expect that most issuers will do so, but the proxy statement must be clear that the vote is not an approval or disapproval of management's recommendation, but a solicitation of votes for one of the four specified choices.
- Issuers may vote uninstructed proxy cards in accordance with management's recommendation, provided that the cards are printed in the form required, and provided they follow the existing requirements of Rule 14a-4: (1) management must include a recommendation for the Say When on Pay Vote, (2) the issuer must permit abstention on the proxy card, and (3) the proxy card must include bold language about the voting of uninstructed shares.
- Application to Newly Public Issuers and TARP Recipients
  - A newly public issuer must include the Say When on Pay Vote in the proxy statement for the issuer's first annual or other meeting of shareholders at which directors are elected following the initial public offering.
  - Issuers subject to TARP are not required to provide the Say When on Pay Vote until the first annual meeting or other meeting of shareholders after all TARP financial assistance has been repaid, and a Dodd-Frank Say on Pay Vote is conducted.
- Effect on Shareholder Proposals
  - The SEC has added a note to Rule 14a-8(i)(10) to permit the exclusion, in certain circumstances, of shareholder proposals that would provide for a Say on Pay Vote for the current year, would seek Say on Pay Votes in future years, or provide for Say When on Pay Votes.<sup>13</sup> Issuers may exclude shareholder proposals if (1) the most recent Say When on Pay vote resulted in a majority of votes cast for one single frequency (i.e. every one, two or three years), and (2) the issuer adopted a policy consistent with that choice.
    - For these purposes, in determining whether a majority of votes were cast for a single frequency, abstentions are not counted as votes cast.
  - If no single frequency received the majority of votes cast, or if one single frequency did receive the majority of votes cast but the issuer did not implement that frequency, an issuer would not be permitted to exclude these shareholder proposals.

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<sup>12</sup> We understand that the principal proxy tabulation firms have modified their systems to accommodate four choices.

<sup>13</sup> Footnote 153 to the Release indicates that no-action requests to exclude shareholder proposals seeking advisory votes on different aspects of executive compensation will be evaluated on a case-by-case basis by the SEC staff.

- Even if a single frequency did not receive a majority of votes cast, a shareholder proposal seeking to set the frequency of Say on Pay Votes at the same intervals as the policy already adopted by the issuer could be excluded under Rule 14a-8 as substantially implemented.
- New Required Disclosure
  - Item 5.07 of Form 8-K requires disclosure of the number of votes cast in a Say When on Pay Vote for each of the four choices (one year, two years, three years, and abstentions).
  - The SEC also revised Item 5.07 of Form 8-K to require an issuer to disclose its decision about how frequently it will conduct Say on Pay Votes.
    - The disclosure must be made no later than 150 calendar days after the date of the meeting at which the Say When on Pay Vote was held, and no fewer than 60 calendar days prior to the deadline for submission of shareholder proposals for the next annual meeting.
  - If an issuer fails to file a timely Form 8-K required by Item 5.07 disclosing its decision, it will lose its eligibility to file Form S-3 registration statements and could be subject to antifraud liability under Section 10(b) and Rule 10b-5 of the Exchange Act.
  - The requirement of disclosure in a Form 8-K was adopted by the SEC in lieu of its proposal to amend Form 10-Q and Form 10-K to require an issuer to disclose its decision regarding the frequency of Say on Pay Votes in the Form 10-Q covering the period in which the shareholder vote occurred, or, if that vote occurred in the fourth quarter, in the issuer's Form 10-K.
- Technical Issues
  - Because the vote is advisory, the SEC did not prescribe a standard for determining which frequency has been “adopted” by the issuer. We believe that the voting standards in an issuer's governing documents also do not apply, since the vote does not seek an “approval.”
  - The Regulations amend Exchange Act Rule 14a-6 to add Say When on Pay Votes to the list of items that do not trigger the requirement to file a preliminary proxy.
- Issues to Consider
  - Issuers will want to determine what voting frequency makes most sense given their particular policies and investor base. A relatively small number of issuers have

filed annual proxies for this proxy season, but of those who have filed to date, the most common recommendation for Say When on Pay Votes is every three years, though many expect that recommendations of annual votes will become more prevalent as the proxy season progresses.<sup>14</sup>

- Issuers may wish to reach out to significant shareholders to discuss their preference in advance of making a recommendation.
- An annual Say on Pay Vote has received support from ISS and from a number of institutional investors as the method that, in their respective views, provides maximum accountability to shareholders.
- However, annual votes may not provide issuers with much opportunity to react to shareholder feedback, particularly in the case of a negative vote. There may also be a risk that annual votes place too much emphasis on short-term performance. Some issuers and institutional shareholders have endorsed triennial votes, arguing that holding the vote every three years provides issuers with time to react to previous votes by changing or modifying their current compensation policies, and that triennial votes encourage shareholders to focus on overall plan design rather than individual decisions. Triennial votes may raise practical considerations for issuers, depending on whether the votes are interpreted by shareholders as a vote every three years on the prior year's compensation as disclosed in the CD&A, or a vote every three years on the totality of the compensation that has been paid by the issuer over the prior three years. The summary compensation table will, of course, include information for the prior three years for NEOs who have been NEOs for the prior three years, but the CD&A and other tables are generally focused principally on decisions made and actions taken in only the prior fiscal year.
- Issuers may wish to provide specific reasons as to why the recommended vote frequency is appropriate for the company. As a practical matter, this is especially true if the issuer recommends a biennial or triennial vote, rather than an annual vote.

### **3. Say on Golden Parachutes – Item 402(t) and Rule 14a-21(c)**

The Dodd-Frank Act requires that issuers include, in any proxy statement or consent solicitation for a shareholder meeting to approve an acquisition, merger, consolidation or sale

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<sup>14</sup> According to data compiled by ISS, as of January 26, 2011, 169 issuers had filed proxy statements with Say When on Pay votes, and of those, 94 issuers (55.6%) recommended triennial votes, 52 (30.8%) recommended annual votes, 13 (7.7%) recommended biennial votes, and 10 issuers (5.9%) made no recommendation. "Monsanto Investors Back Annual Pay Votes," *ISS Governance Weekly* (January 28, 2011), available at <http://www.issgovernance.com>. In the week since the Say When on Pay requirements became effective, the majority of shareholders at two companies, Costco Wholesale and Johnson Controls, voted for annual Say on Pay Votes over management's recommendation of a triennial vote.



of substantially all of an issuer's assets, disclosure of "Golden Parachute" arrangements (generally, compensation arrangements that are triggered by a change in control of the issuer as described more fully below) and a corresponding shareholder advisory vote on the parachutes disclosed (the "Say on Golden Parachutes Vote"). The Regulations provide that the Golden Parachutes disclosure and Say on Golden Parachutes Vote will be required in applicable filings (as discussed in more detail below) initially made on or after April 25, 2011.

A. Disclosure Requirements – Item 402(t)

- Disclosure Required
  - The Regulations require:
    - Disclosure of all golden parachutes (in the form described below) of the NEOs of each of the target and acquiring companies which are based on or otherwise relate to the transaction between the target and acquiring companies.
      - For this purpose, NEOs are those executive officers for whom disclosure was required in the issuer's most recent filing with the SEC under the Securities Act of 1933, as amended or the Exchange Act that required Summary Compensation Table disclosure, but do not include any individuals included in the Summary Compensation Table who were no longer executive officers at the end of the last completed fiscal year. However, issuers are permitted to add additional NEOs to the table, so long as the inclusion is not misleading.
      - Consistent with the proposed rules, the Regulations also require disclosure of Golden Parachutes between an acquiring company and the NEOs of a soliciting target company.
    - Quantitative disclosure to be presented in a "Golden Parachute Compensation" table.<sup>15</sup> The Regulations clarify that only compensation that is based on or otherwise relates to the subject transaction must be disclosed in the table. Presumably, in circumstances where the issuer is voluntarily

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<sup>15</sup> We note that the SEC's choice to use the term "Golden Parachute" in the title of the table required by Item 402(t)(2) (as opposed to a more neutral term such as "change in control compensation") seems to prejudge the character of the compensation contained within the table. The term, though commonly used in colloquial communications, does bring to mind rich, excessive, overly-generous compensation packages for executives who are cushioned by, and float away on, their gilded parachutes. Although issuers cannot change the name of the table, we expect that many may want to avoid the use of the somewhat charged term "Golden Parachute" in their footnote and narrative disclosure, in favor of more neutral terminology.

providing the disclosure in an annual proxy statement and no specific transaction is contemplated, the table will include a broader range of compensation. The table includes separate columns for the aggregate dollar value of each of the following items:

- Cash severance payments (including pro rata bonuses),
  - Value of stock-based awards which are cashed out<sup>16</sup> or for which vesting is accelerated (using intrinsic value for stock options),
  - Enhancements of pension and nonqualified deferred compensation benefits,
  - All perquisites and other personal benefits (with no de minimis exclusion),
  - Health and welfare benefits, including nondiscriminatory, broad-based programs,<sup>17</sup>
  - Tax reimbursements,
  - “Other” payments or benefits not otherwise covered by the above, and
  - The total value of the foregoing items.
- In addition to the foregoing required columns, issuers are permitted to add additional columns or rows to the table, such as to disclose cash severance separately from other cash compensation or to distinguish “single-trigger” and “double-trigger” arrangements, so long as such disclosure is not misleading.
  - Tabular quantification of amounts payable must be determined assuming a triggering event as of the latest practicable date and using the deal

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<sup>16</sup> Item 402(t)(2)(iii)(C) requires disclosure of “payments in cancellation of stock and option awards.” Based on language in the Release that clearly states that Item 402(t) “as proposed and adopted, also does not require disclosure or quantification of previously vested equity awards” and that “previously vested equity awards are not compensation ‘that is based on or otherwise relates to the transaction,’” we read this to require disclosure only in respect of payment in cancellation of unvested stock and option awards.

<sup>17</sup> This is a departure from the requirements of Item 402 generally, which do not require disclosure of information regarding 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 issuer and that are generally available generally to all salaried employees. (See Item 402(a)(6)(ii)).

consideration per share, if such value is a fixed dollar amount, or otherwise using the average closing market price per share of the issuer's securities over the first five business days following the first public announcement of the transaction. Consistent with calculations made pursuant to Item 402(j), if uncertainties exist, the issuer is required to make a reasonable estimate and disclose the material assumptions underlying the estimate, but unlike Item 402(j), Item 402(t) does not permit the disclosure of an estimated range of payments.

- Where the Golden Parachute disclosure is being provided in proxy or consent solicitation materials seeking shareholder approval for any acquisition, merger, consolidation or sale of substantially all of an issuer's assets and the Golden Parachute Compensation table includes Golden Parachutes between an acquiring company and the NEOs of the soliciting target company, the issuer would be required to provide a separate table disclosing only those Golden Parachutes that will be subject to the Say on Golden Parachutes Vote.
- Footnote disclosure quantifying each separate form of compensation reported (with perquisites identified and quantified in accordance with the existing compensation disclosure rules<sup>18</sup> and health benefits quantified using GAAP financial reporting assumptions).
- Footnote disclosure identifying amounts attributable to single trigger and double trigger arrangements and, in the latter case, specifying the time range in which termination of employment must occur.
- A succinct narrative description of any material factors necessary to understand the Golden Parachutes and the Golden Parachute Compensation table, including but not limited to triggering circumstances, time of payment (*e.g.*, lump sum or over specified period), payor of compensation and the details of any material conditions or obligations to which payment is subject (*e.g.*, a noncompete covenant and its extent, duration and waiver provisions).
- For a discussion of new Item 24 of Schedule 14A, which requires certain disclosure in proxy statements regarding the effect of a Say on Golden Parachutes Vote, see page 16 below.

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<sup>18</sup> See Instruction 4 to Item 402(c)(2)(ix).

- Disclosure Not Required
  - The Regulations state that no disclosure is required under Item 402(t) with respect to:
    - Previously vested equity awards and agreements; and
    - Understandings with senior management of foreign private issuers where the target or acquirer is a foreign private issuer.
  - The Release states that no disclosure is required of compensation to be paid under a bona fide post-transaction employment agreement to be entered into in connection with the transaction. This may raise interpretive questions as to what constitutes a “bona fide” employment agreement for post-transaction services. For example, if an acquiror enters into transitional arrangements for a limited period post-closing and/or provides target NEOs with single-trigger “walk away” rights after a required service period, would those be considered “bona fide” arrangements? We think the better reading of the Release and the Regulations is to interpret this exception broadly, but time will tell what practices develop in this regard.
  - If an issuer voluntarily includes the Item 402(t) disclosure in an annual proxy statement then it is not required to provide the 402(j) disclosure with respect to change in control payments. The issuer would still be required, however, to include disclosure in accordance with Item 402(j) about payments that may be made upon termination of employment.
- When and Where Disclosure is Required
  - In addition to proxy or consent solicitation materials seeking shareholder approval for any acquisition, merger, consolidation or sale of substantially all of an issuer’s assets, the Regulations go beyond the scope of the Dodd-Frank Act, requiring Item 402(t) disclosure of Golden Parachutes to be included in any:
    - Information statement filed pursuant to Regulation 14C.
    - Proxy or consent solicitation statement not containing merger proposals but requiring disclosure of information under Item 14 of Schedule 14A pursuant to Note A (e.g., seeking approval for issuance of shares to conduct a merger transaction).
    - Registration statements on Forms S-4 and F-4 containing disclosure relating to mergers and similar transactions.

- Going private transaction on Schedule 13E-3 (except where the target or subject issuer is a foreign private issuer).
- Schedule 14D-9 solicitation/recommendation statements.
  - The Regulations eliminate the proposed requirement that Item 402(t) disclosure be included in third party tender offers on a Schedule TO, unless the third party tender offer is also a Rule 13e-3 going private transaction. The proffered rationale is two-fold: first that a bidder in a third party tender offer may face difficulties in obtaining the information necessary to provide the disclosure required by Item 402(t)<sup>19</sup> and second that it is not necessary to require the bidder to provide this information since target companies will be required to provide the disclosure in the Schedule 14D-9, filed by the tenth business day following the date the tender offers are first published, sent, or given to security holders.

B. Shareholder Advisory Vote Requirements – Rule 14a-21(c)

Although the Regulations expand the scope of the persons covered by, and the filings which must contain, the Golden Parachutes disclosure, the Regulations do not go beyond the express requirements of the Dodd-Frank Act in respect of which Golden Parachutes are subject to a shareholder advisory vote. As a result, the Regulations require that in any proxy or consent solicitation for a shareholder meeting to approve an acquisition, merger, consolidation or sale of substantially all of an issuer's assets initially filed on or after April 25, 2011, a soliciting acquiror must include a separate resolution subject to shareholder advisory vote to approve Golden Parachutes with its NEOs and with the target's NEOs and a soliciting target must include a separate resolution subject to shareholder advisory vote to approve Golden Parachutes with its NEOs and with the acquiror's NEOs, in each case as they are disclosed in the proxy or consent solicitation, unless they were previously the subject of a Say on Pay Vote. As with the Say on Pay Vote, Section 14A(c) of the Exchange Act provides that the Say on Golden Parachutes Vote is non-binding and not intended to overrule any board or issuer decision, create or imply any change or addition to the fiduciary duties of the board or the issuer or restrict shareholder proposals about executive compensation matters.

- Golden Parachutes Not Subject to a Shareholder Vote
  - The Regulations specify that a separate shareholder vote on golden parachute arrangements is required only in the circumstances set forth in the Dodd-Frank Act. As a result, although required to be disclosed under Item 402(t) when a target

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<sup>19</sup> Consequently, the Regulations do not include proposed Instruction (2) to Item 1011(b) of Regulation MA, which provided that a bidder's disclosure of Item 402(t) information on a Schedule TO need only be provided to the extent known to the bidder after making reasonable inquiry.

company conducts a proxy or consent solicitation, Golden Parachutes between the acquiring company and the NEOs of the soliciting target company need not be subject to a shareholder vote.

- Similarly, although disclosure of Golden Parachutes must be included in a variety of forms in connection with corporate transactions (as discussed above), a Say on Golden Parachutes Vote will be required only in any proxy statement or consent solicitation for a shareholder meeting to approve an acquisition, merger, consolidation or sale of substantially all of an issuer's assets initially filed on or after April 25, 2011.
- As noted above, the Regulations provide that if Golden Parachutes were previously subject to a Say on Pay Vote, regardless of the outcome of the Say on Pay Vote, a separate Say on Golden Parachutes Vote will not be required in connection with an applicable transaction (although Golden Parachutes will still be required to be disclosed). The following requirements apply for an issuer to rely on this exception:
  - The Golden Parachutes must have been disclosed in the format required by Item 402(t) in an annual meeting proxy statement, using the last business day of the issuer's last completed fiscal year for the triggering event date and stock price determination.
  - The terms of the Golden Parachutes as disclosed in the format required by Item 402(t) and previously subject to the Say on Pay Vote have not been modified *in any way*.
  - Any new arrangements or revisions (except to the extent that a revision results only in a reduction in the value of total compensation payable) would be subject to a separate Say on Golden Parachutes Vote, but the existing arrangements and unchanged provisions (though still required to be disclosed) would not be subject to such vote.
    - To rely on the exception in respect of the unmodified arrangements, the issuer would be required to include two Golden Parachute Compensation tables in the applicable disclosure document, one with complete aggregate information of all Golden Parachute arrangements and one with only the new arrangements or revised terms that will be subject to the Say on Golden Parachutes Vote.
    - If the Golden Parachute Compensation table includes Golden Parachutes between an acquiring company and the NEOs of the soliciting target company, the issuer would be required to provide a separate table disclosing only those Golden Parachute arrangements

that will be subject to the shareholder advisory vote.

- Generally, updates to change the value of items to reflect stock price movement would not count as modifications, but in certain circumstances (for example, if an increase in the issuer's share price would result in an Internal Revenue Code Section 280G tax gross-up becoming payable) the update would count as a revision and trigger a Say on Golden Parachutes Vote. The addition of a new NEO, new equity grants (even with the same terms as awards previously subject to a Say on Pay Vote), and increases in salary would require a Say on Golden Parachutes Vote.
- Issues to Consider
  - We expect that many companies will conclude that the Say on Golden Parachutes Vote is unlikely to have practical impact and, therefore, changes to parachute arrangements or practices should not be needed at this time in light of the new voting requirement. Management should nonetheless review this issue with the compensation committee.<sup>20</sup> Although a Say on Golden Parachutes Vote may be unlikely to impact consummation of a transaction, a negative shareholder vote may attract negative press attention and pose reputational risks for continuing directors.
  - Issuers should consider the benefit offered (versus the burden undertaken) by including the Golden Parachutes disclosure under Item 402(t) in its annual proxy statement for shareholder approval. We expect that many issuers will conclude that the exception is too narrowly drawn to be of much practical utility, but it is nevertheless worth considering.
    - Since even a minor change to existing compensatory arrangements, such as a new equity grant in the ordinary course (or an increase in potential gross-up obligations due to movement in the issuer's stock price), would trigger a Say on Golden Parachutes Vote, the exception may not confer a particular advantage. Issuers should note that in circumstances in which there has been even a modest or de minimis change to existing Golden Parachutes and they wish to rely on the exception for those Golden Parachute arrangements that had previously

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<sup>20</sup> Most companies have recently reviewed their golden parachute arrangements in light of the scrutiny given to these arrangements by institutional investors. For those companies, the new voting requirement may not be enough to motivate further change. However, a review of the voting guidelines of significant shareholders may nevertheless be worthwhile. For example, in its February 2010 proxy voting guidelines summary, ISS stated that an acceptable golden parachute has, at a minimum: (x) a triggering mechanism beyond the control of management; (y) a payment of no more than three times the executive's average annual W-2 compensation during the five years prior to the year in which the change of control occurs; and (z) a double-trigger payment structure.

been subject to an Say on Pay Vote, they would actually be required to include more extensive Golden Parachutes disclosure than if they chose to not rely on the exception. In this case, the issuer would be required to include at least two Golden Parachute tables in the merger proxy or consent solicitation (one with complete information and one with only the new arrangements or revised terms). As a result, in these circumstances, reliance on the exception increases the disclosure burden, may disproportionately focus shareholder attention on the Golden Parachutes in general, and the new arrangements or revisions in particular, even where those changes occur only in the ordinary course, and may be confusing to shareholders.

- To the extent that the changes arise only from the addition of a new NEO and an issuer wishes to rely on the exception for its other Golden Parachutes, the issues described above may be particularly acute. In this circumstance, an issuer would be required to highlight in a separate table the individual NEO's compensation, and request a shareholder advisory vote of only that one NEO's payments and benefits. In this circumstance it seems extremely unlikely that many issuers would choose to rely on the exception.

#### **4. Disclosure of Shareholder Advisory Votes – Item 24 of Schedule 14A**

- Disclosure Required
  - Item 24 of Schedule 14A requires, in any proxy statement in which the issuer is providing any of the advisory votes described above, disclosure that each such vote is being provided as required pursuant to Section 14A of the Exchange Act and a brief explanation of the general effects of the vote, including whether the vote is non-binding. Following the implementation of a frequency policy, the proxy should also disclose the current frequency of the Say on Pay Vote and when the next such vote will occur.
- Issues to Consider
  - Since the effective date of Item 24 is April 4, 2011, this disclosure will have to be included in 2011 annual proxy statements which are filed after that date. Although not technically required, issuers may consider including the disclosure in 2011 annual proxy statements filed prior to April 4th.
    - An explanation of the effect of the Say on Pay Vote may include a statement that, though the vote is advisory only and not binding upon the issuer, the board or the compensation committee, as appropriate, will consider the outcome of the vote as one factor in making future compensation decisions, in conjunction with other factors such as feedback



from shareholder outreach programs.

- An explanation of the effect of the Say When on Pay Vote may include a statement that the board or the compensation committee, as appropriate, will consider the outcome of the vote in deciding how frequently to conduct Say on Pay Votes, but will not be bound either by its own recommendation or by the outcome of the vote, and may choose to conduct the vote more or less frequently in the future based on other factors, such as feedback from shareholder outreach programs, the adoption or revision of compensation policies, or the outcome of Say on Pay Votes.
- An explanation of the effect of the Say on Golden Parachutes Vote will depend on the circumstances of the transaction, but may include a statement that, though the vote is advisory only and non-binding, the soliciting issuer will consider the outcome of the vote when making future decisions about change in control compensation.

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Please feel free to call any of your regular contacts at the firm or any of the partners and counsel listed under Employee Benefits or Corporate Governance in the Practices section of our website ([www.cgsh.com](http://www.cgsh.com)) if you have any questions.

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**APPENDIX A**

**Say On Pay / Say When On Pay / Say on Golden Parachutes  
Key Differences between SEC Proposed Regulations and Final Regulations**

<b>Say on Pay</b>			
<b>Rule, Item or Instruction</b>	<b>Topic</b>	<b>SEC Proposed Regulations (October 18, 2010)</b>	<b>SEC Final Regulations (January 25, 2011)</b>
Rule 14a-21(a)	Meetings at which Say on Pay Votes are required	Votes are required with respect to annual or other meetings of shareholders for which executive compensation disclosure is required pursuant to Item 402.	Votes are required with respect to annual or other meetings of shareholders for which executive compensation disclosure is required pursuant to Item 402, and at which proxies are solicited for the election of directors.
Rule 14a-21(a)	Required frequency of Say on Pay Votes	Votes are required at least once every three years from the date of the most recent vote.	Votes are required at least once every three calendar years.
Instruction to Rule 14a-21(a)	Form of Say on Pay resolution	The Say on Pay Vote must relate to all executive compensation disclosure disclosed pursuant to Item 402. No instruction provided.	An instruction states that the resolution must indicate that the vote is “to approve the compensation of executives, as disclosed pursuant to Item 402 of Regulation S-K or any successor thereto.” The instruction also provides a non-exclusive sample of a resolution satisfying the requirements of the rule.
Item 402(b) of Regulation S-K	Additional disclosure in the CD&A	Disclosure is required as to whether, and if so, how, the issuer has considered the results of previous Say on Pay Votes in determining compensation policies and decisions, and how the vote affected such decisions.	Disclosure is required as to whether, and if so, how, the issuer has considered the results of only the most recent Say on Pay Vote in determining compensation policies and decisions, and how the vote affected such decisions.
Rule 14a-6	Filing of Preliminary Proxy Statements	Say on Pay and Say When on Pay Votes required by Section 14A(a) would be added to the list of items that do not trigger a preliminary proxy statement filing.	In addition to Say on Pay and Say When on Pay Votes required by Section 14A(a), other shareholder advisory votes on executive compensation will not trigger a preliminary proxy statement filing.

<b>Say When on Pay</b>			
<b>Rule, Item or Instruction</b>	<b>Topic</b>	<b>SEC Proposed Regulations (October 18, 2010)</b>	<b>SEC Final Regulations (January 25, 2011)</b>
Rule 14a-21(b)	Meetings at which Say When on Pay Votes are required	Votes are required with respect to annual or other meetings of shareholders for which executive compensation disclosure is required pursuant to Item 402.	Votes are required with respect to annual or other meetings of shareholders for which executive compensation disclosure is required pursuant to Item 402, and at which proxies are solicited for the election of directors.
Rule 14a-21(b)	Required frequency of Say When on Pay Votes	Votes are required at least once every six years from the date of the most recent vote.	Votes are required at least once every six calendar years.
Rule 14a-8	Exclusion of shareholder proposals	Shareholder proposals may be excluded if the issuer has adopted a policy on the frequency of Say on Pay Votes that is consistent with the <i>plurality</i> of the votes cast in the most recent Say When on Pay Vote.	Shareholder proposals may be excluded only if the issuer has adopted a policy on the frequency of Say on Pay Votes that is consistent with the <i>majority</i> of the votes cast in the most recent Say When on Pay Vote.
<b>Say on Golden Parachutes</b>			
<b>Rule, Item or Instruction</b>	<b>Topic</b>	<b>SEC Proposed Regulations (October 18, 2010)</b>	<b>SEC Final Regulations (January 25, 2011)</b>
Instruction 1 to Item 402(t)(2) of Regulation S-K	Quantification of amounts in the Golden Parachute Compensation table	Amounts in the Golden Parachute Compensation table are quantified using the closing market price per share of the issuer's securities as of the latest practicable date.	Amounts in the Golden Parachute Compensation table are quantified using the deal consideration per share, if such value is a fixed dollar amount, or otherwise using the average closing market price per share of the issuer's securities over the first five business days following the first public announcement of the transaction.
Instruction 1 to Item 402(t)(2)	Compensation disclosed in the Golden Parachute Compensation table	Issuers are required to disclose in the Golden Parachute Compensation table each of the items specified in Item 402(t)(2)(i) – (viii).	Issuers are required to disclose in the Golden Parachute Compensation table each of the items specified in Item 402(t)(2)(i) – (viii) and are required to include only compensation that is based on or otherwise relates to the subject transaction.

Instruction 2 to Item 1011(b) of Regulation MA and Exchange Act Rule 14d-100	Information required to be included in a Schedule TO	Bidder in a third party tender offer must disclose in its Schedule TO the information required by Item 402(t) to the extent such information is known to the bidder after making reasonably inquiry.	Bidder in a third party tender offer is not required to disclose in its Schedule TO the information required by Item 402(t). Note that Item 402(t) disclosure will still be required in the Schedule 13E-3 in third party tender offers that are also Rule 13e-3 going private transactions (Item 15 of Schedule 13E-3).
Rule 14a-21(c)	Format of Say on Golden Parachutes Vote	The issuer must provide a separate shareholder vote to approve certain Golden Parachutes.	The issuer must include a separate shareholder resolution subject to shareholder advisory vote to approve certain Golden Parachutes.
<b>Disclosure of Shareholder Advisory Votes</b>			
<b>Rule, Item or Instruction</b>	<b>Topic</b>	<b>SEC Proposed Regulations (October 18, 2010)</b>	<b>SEC Final Regulations (January 25, 2011)</b>
Item 24 of Schedule 14A	Information required in the Proxy Statement	Any proxy statement in which an issuer is providing any of the shareholder advisory votes must include disclosure that each such vote is being provided as required by Section 14A of the Exchange Act and a brief explanation of the general effect of the vote, such as whether it is non-binding.	Any proxy statement in which an issuer is providing any of the shareholder advisory votes must include disclosure that each such vote is being provided as required by Section 14A of the Exchange Act, a brief explanation of the general effect of the vote, such as whether it is non-binding, the current frequency of the Say on Pay Vote and when the next such Say on Pay Vote will occur.
Form 10-Q / Form 10-K / Item 5.07 of Form 8-K	Disclosure of decision regarding Say When on Pay	Form 10-K and Form 10-Q are amended to require disclosure of the issuer's decision as to how frequently the issuer will conduct Say on Pay Votes for the six subsequent years. An issuer is required to disclose the decision in the Form 10-Q covering the quarterly period in which the Say on Pay Vote occurs, or in Form 10-K if the vote occurs during the issuer's fourth quarter.	Issuers are required to disclose their decision regarding how frequently Say on Pay Votes will be conducted following each Say When on Pay Vote. The decision must be disclosed in an Item 5.07 Form 8-K no more than 150 calendar days following the date of the meeting at which the vote took place, and no fewer than 60 calendar days prior to the deadline for the submission of shareholder proposals under Rule 14a-8 for the subsequent shareholder meeting.  Forms 10-K and 10-Q are not amended.

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