November 5, 2010

EXEQUITY

Independent Board and Management Advisors

Client Alert

SEC Proposes Rules Regarding Shareholder Approval of Executive Compensation and Golden Parachute Compensation

On October 18, 2010, the Securities and Exchange Commission (the "SEC") issued proposed rules to implement the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") with respect to:

- "Say on Pay"—Nonbinding shareholder advisory vote on the executive compensation disclosures in the proxy;
- "Say When on Pay"—Nonbinding shareholder advisory vote on the frequency with which shareholders will vote on the executive compensation disclosures; and
- "Say on Golden Parachutes"—Disclosure and nonbinding shareholder advisory vote on golden parachute arrangements when shareholders are asked to approve a merger or other corporate transaction.

The purpose of this Client Alert is to summarize the key provisions of the proposed rules and briefly discuss potential implementation issues.

Comments on the proposed rules are due by November 18, 2010 and the SEC is expected to issue final rules in the first quarter of 2011.

Exequity Comment*: The SEC's proposed rules provide companies with guidance on some of the most pressing questions, particularly with respect to the "Say When on Pay" vote. Calendar-year companies are in the process of preparing drafts of their proxy statements and companies with fiscal year-ends ending on or after September 30, 2010 are in the final stages of getting their proxies out the door—thus, some guidance from the SEC was sorely needed. However, a number of questions remain unanswered and the proposed rules have raised additional questions. Hopefully, many of these will be addressed in the final rules. In the meantime, companies subject to the effective date for including "Say on Pay" and "Say When on Pay" resolutions in their proxies should follow the guidance in the proposed rules even if proxy statements need to be filed before final rules are adopted.*

Effective Date

Dodd-Frank requires separate resolutions on “Say on Pay” and “Say When on Pay” in a company’s proxy statement relating to its first annual meeting (or special meeting in lieu of an annual meeting) that occurs on or after January 21, 2011. The “Say on Golden Parachutes” will not become effective until the SEC issues its final rules. The effective dates apply regardless of when the proxy is filed, whether the proxy filed is preliminary or final, and whether the SEC has adopted final rules.

Highlights of the Proposed Rules

- The Say on Pay vote must be a vote to approve all of the executive compensation disclosures included in the proxy.
- The Say When on Pay vote must provide for a choice among every year, every two years, every three years, or abstain.
- The SEC is not prescribing any specific language or form for the resolutions.
- The CD&A must discuss whether (and, if so, how) the compensation policies and programs have taken into account the results of a prior required Say on Pay vote.
- The company must disclose in its 10-Q (or 10-K, if applicable) its decision with respect to the Say When on Pay vote.
- Say on Pay or Say When on Pay vote resolutions do not require the filing of a preliminary proxy.
- Disclosure with respect to Say on Golden Parachutes requires a formatted and more comprehensive disclosure than what is currently required.

Say on Pay

Dodd-Frank amends the Securities Exchange Act of 1934 (the “Exchange Act”) by adding new Section 14A(a)(1) which requires, no less frequently than once every three years, a separate, nonbinding shareholder advisory vote on the executive compensation disclosures required in the proxy. The separate shareholder vote is only required when proxies are solicited for the election of directors with respect to an annual meeting of shareholders (or special meeting in lieu of an annual meeting). The SEC’s proposed rules provide further:

- Shareholders would vote to approve all of the items covered by the executive compensation disclosures, including the Compensation Discussion and Analysis (“CD&A”), the compensation tables, and other narrative explanations. Director compensation is excluded as well as the disclosure required by Item 402(s) of Regulation S-K relating to the issuer’s compensation policies and practices as they pertain to risk management and risk-taking incentives for employees generally.
- The SEC is not prescribing any specific language or form for the resolution.

- Companies must disclose in the proxy that they are providing a separate Say on Pay vote and briefly explain the general effect of the vote (e.g., that it is nonbinding).
- The CD&A would be required to include a discussion of whether and, if so, how a company's compensation policies and decisions have taken into account the results of a previous Say on Pay vote that is required under new Section 14A(a)(1).

Exequity Comment*: The only surprise (and additional rule not mandated by Dodd-Frank) is the requirement to discuss in the CD&A whether compensation policies and decisions have taken into account the results of the prior Say on Pay vote. Note that this disclosure will not be required until 2012 proxies (discussing the Say on Pay vote in 2011). This is the case even if a company voluntarily included a Say on Pay vote in its proxies before the mandatory effective date.*

However, it is unclear what is intended to be discussed, particularly since the vote is an "up" or "down" vote that does not provide the company with any information on the compensation policies shareholders like or dislike. Also, shareholders are a diverse group and their views and/or reasons for voting for or against the Say on Pay proposal are likely equally diverse. In addition, some shareholders may vote against a Say on Pay proposal to express their dissatisfaction with other company policies and not necessarily executive pay.

It is important to also note that Institutional Shareholder Services, Inc. (ISS) and other proxy advisory firms are likely to be influential for many institutional shareholders who will outsource the analysis because they lack the staff to fully analyze a Say on Pay vote.

Say When on Pay

New Section 14A(a)(2) of the Exchange Act requires that issuers provide a separate, nonbinding advisory vote to determine the frequency of the Say on Pay vote at least once every six years. As with the Say on Pay vote, the separate shareholder Say When on Pay vote would be required only with respect to an annual meeting of shareholders for which proxies are solicited for the election of directors (or a special meeting in lieu of such annual meeting). The SEC's proposed rules provide further:

- Shareholders must be given four choices on a single ballot: specifically, do they prefer to be presented with a Say on Pay vote every one, two, or three years or do they abstain from voting.
- Companies must disclose that they are providing a separate Say When on Pay vote and they must explain the general effect of the vote, such as whether the vote is nonbinding.
- A company's board of directors may include a recommendation as to how shareholders should vote on frequency; however, the resolution must make it clear that the proxy card provides for four choices and that shareholders are not voting to approve or disapprove the board's recommendation.
- The SEC refused to prescribe a standard for determining which frequency has been adopted by the shareholders. Because four choices are presented, it is very possible that no choice will result in a majority vote. Rather, the SEC proposed rules for determining whether a company can exclude a shareholder proposal relating to Say on Pay or Say When on Pay votes. The SEC is proposing that a company can exclude as "substantially implemented" a shareholder proposal that seeks a Say on Pay vote or relates to the frequency of Say on Pay votes if the company has implemented the frequency that is consistent with the plurality of the votes cast.

- The company must disclose in the Form 10-Q that covers the period during which the Say When on Pay vote occurs (or Form 10-K if the vote occurs during the fourth quarter) its decision regarding frequency. Note that the actual results of the vote are still required to be reported on Form 8-K within four business days following the day of the shareholder meeting.

Exequity Comment*: Many companies are wrestling with the decision of the voting frequency they will recommend and based on our conversations with our clients, companies seem to be falling primarily into one of two camps, either annual or triennial. The argument for an annual frequency is that the Say on Pay vote will be viewed by shareholders as part of the normal course and, thus, may be subject to less scrutiny. Some companies have also expressed concern that if shareholders are dissatisfied with executive compensation and a Say on Pay vote is not conducted annually, there is greater risk that shareholders may instead withhold or vote against compensation committee members in the "off years" (when a Say on Pay vote is not on the ballot). However, this concern may be overblown because for companies that have a majority vote standard for the election of directors, it is rare that directors fail to receive majority support (as of September 1, 2010, only 88 directors failed to earn majority support and this was down from 93 for the same time period during the previous year).*

The argument for a longer frequency, such as triennial, is that an annual vote further promotes "short-term" thinking with respect to executive compensation. Because the majority of compensation is long-term, a shareholder vote with a longer frequency is more consistent with and more aligned with longer-term compensation objectives. Keep in mind that a decision with respect to the vote frequency does not need to be made until ***after*** *the votes come in. If triennial is recommended but the results show a majority support or even plurality for annual, the company can make a decision to adopt annual. It would likely be more difficult for a company to make a decision to adopt triennial after it had recommended for an annual frequency.*

It should be noted that ISS recently released for comment its initial policy position on Say When on Pay, which is to vote in favor of companies providing for annual proposals. ISS believes that an annual frequency provides for the highest level of accountability and direct communication by enabling the vote to correspond to the information presented in the accompanying proxy statement. Having Say on Pay votes only every two or three years, potentially covering all actions occurring between the votes, would make it difficult to create meaningful and coherent communication that the votes are intended to provide. Nevertheless, regardless of the policy ISS adopts, we believe that companies should recommend the frequency that is best for their business and clearly articulate their rationale in the resolution. With respect to frequency, we believe this is one area where institutional shareholders will not necessarily lock-step with the ISS recommendation for the following reasons:

- *The work required to determine a voting position on frequency is not nearly as intensive as what is required to determine a voting position on Say on Pay, and many institutional investors will be able to determine or develop their own policies without outsourcing to ISS.*
- *There are a number of institutional investors that oppose an annual frequency.*
- *Many institutional investors do not favor a vote frequency that is applied to all companies, regardless of circumstances. Rather, they will evaluate Say When on Pay resolutions on a case-by-case basis after evaluating a company's rationale for its recommendation.*

Issues Relating to Both Say on Pay and Say When on Pay Votes

The SEC's proposed rules would also provide:

- The Say on Pay and Say When on Pay votes would be added to the list of items that would **not** trigger a preliminary proxy filing.
- Brokers would be precluded from voting instructed shares for either a Say on Pay or Say When on Pay vote.
- Companies which have received financial assistance under the Troubled Asset Relief Program (TARP) would not conduct a separate Say on Pay vote because they are already required to provide effectively the same vote pursuant to the Emergency Economic Stabilization Act of 2008 (EESA). Also, because EESA requires an annual vote, companies would not be required to conduct the Say When on Pay Vote until they are no longer subject to TARP. TARP companies would be required to include the Say When on Pay vote for the first annual meeting of shareholders after the company has repaid all its outstanding indebtedness under the TARP.

Disclosure of Golden Parachutes and Say on Golden Parachutes

New Section 14A(b) of the Exchange Act addresses disclosure and voting requirements if a company is soliciting the approval of an acquisition, merger, consolidation, or proposed sale of all or substantially all of a company's assets ("Proposed Transaction").

Disclosure

Section 14A(b)(1) proposes a broad disclosure requirement. All companies making a proxy or consent solicitation seeking shareholder approval of a Proposed Transaction must provide disclosure of any agreements or understandings they have with their named executive officers (NEOs) or with the NEOs of the acquiring issuer concerning compensation, whether present, deferred, or contingent, that is based on or relates to the Proposed Transaction ("Golden Parachute Compensation"). A target company soliciting shareholder approval of a Proposed Transaction is not required to disclose Golden Parachute Compensation between its NEOs and the acquiring issuer. If the acquiring issuer is making a proxy or consent solicitation, it must disclose Golden Parachute Compensation it has with its NEOs or with the NEOs of the target company. Compensation related to post-transaction agreements is not considered Golden Parachute Compensation.

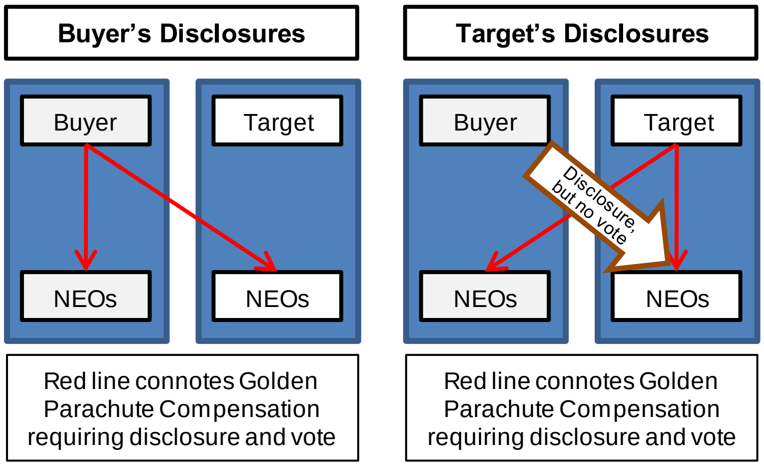
Disclosure must be in a "clear and simple form" and must include the aggregate total of all compensation that may be paid or become payable to the NEO. Accordingly, the SEC is proposing to add Item 402(t) to Regulation S-K. Item 402(t) would require the disclosure, in both a tabular and narrative format, of **all** Golden Parachute Compensation relating to the Proposed Transaction **among the target and acquiring companies and the NEOs of each. Thus, Item 402(t) requires disclosure of a broader group of Golden Parachute Compensation than is required by Exchange Act 14A(b)(1) as described above**.[1] In other words, the Item 402(t) disclosure **will** require the disclosure of arrangements between an acquiring company and the NEOs of the target company. Thus, in cases where the 402(t) disclosure

---

[1] Item 402(t) disclosure would also be required in information statements filed pursuant to Regulation 14C, proxy or consent solicitations that do not contain merger proposals but require disclosure of information under Item 14 of Schedule 14A, registration statements on Forms S-4 and F-4 containing disclosure relating to mergers and similar transactions, going-private transactions on Schedule 13E-3, and third-party tender offers on Schedule TO and Schedule 14D-9 solicitation/recommendation statements.

includes arrangements between an acquiring company and the target company NEOs, a separate table must be provided of the arrangements required to be disclosed under Section 14A(b)(1) and subject to the shareholder advisory vote. The graphic below illustrates the required disclosures:

Disclosures and Votes Required



The format of the proposed table follows:

Name (a)	**Cash ($) (b)**	**Equity ($) (c)**	**Pension/ NQDC ($) (d)**	**Perquisites/ Benefits ($) (e)**	**Tax Reimbursement ($) (f)**	**Other ($) (g)**	**Total ($) (h)**
PEO							
PFO							
A							
B							
C							

The following provides a description of what is required for each column:

- Cash—Any cash severance payment (e.g., base salary, bonus, nonequity incentive plan compensation).
- Equity—Dollar value of accelerated stock awards, in-the-money option awards for which vesting is accelerated, and payments for cancelled stock or option awards.
- Pension/NQDC—Benefit enhancements related to pension or nonqualified deferred compensation.
- Perquisites/Benefits—Perquisites and other personal benefits and health and welfare benefits.
- Tax Reimbursements—Include 280G tax gross-ups.
- Other—Any additional elements of compensation not specifically includable in the other columns.
- Total—The aggregate total of the amounts in the preceding columns.

All of the columns would require footnote identification of each separate form of compensation reported. Also, footnotes would be required to identify amounts attributable to “single trigger” and “double trigger” arrangements.

The narrative disclosure would require companies to describe any material conditions or obligations applicable to the receipt of the Golden Parachute Compensation (e.g., noncompete, nonsolicitation, nondisparagement, or confidentiality agreements, their duration, and provisions regarding waiver or breach). Companies must also disclose the circumstances that would trigger payment, whether the payments are lump-sum or annual and their duration, and any other material factor.

It is important to note that new Item 402(t) (applying only to disclosures related to a Proposed Transaction) differs from the current 402(j) disclosure requirements (applying to regular, annual proxy disclosures) relating to termination and change-in-control payments:

- Existing Item 402(j) does not apply to proxies related to Proposed Transactions.
- New Item 402(t) only relates to Golden Parachute Compensation whereas Item 402(j) relates to payments in connection with any termination or a change in control.
- Existing Item 402(j) does not require a tabular disclosure, does not require disclosure of an aggregate total, and does not require disclosure about arrangements that do not discriminate in scope, terms, or operation in favor of executive officers and that are generally available to all salaried employees. Item 402(j) also permits the exclusion of perquisites or other personal benefits if the aggregate amount of such compensation is less than $10,000.

Exequity Comment*: The disclosure requirements are beyond confusing and shareholders will have trouble navigating through the disclosures in Item 402(t) compared to the disclosures that are required under Section 14A(b)(1) and which are the subject of the shareholder vote related to a Proposed Transaction. On top of that, the disclosures in current Item 402(j) will be different still from the Item 402(t) disclosures.*

Also, one area of continuing debate and discussion has been whether the annual Item 402(j) disclosure should include only the incremental amounts related to the termination event or change in control or the “all in” amount which includes already vested amounts that are reported in other tables. The SEC makes clear in this proposed release that only incremental disclosure is required under Item 402(t). We expect that this will give companies additional comfort in only including incremental disclosure in Item 402(j) disclosures.

Shareholder Vote

Section 14A(b)(2) requires a separate, nonbinding shareholder advisory vote on Golden Parachute Compensation in connection with mergers and similar transactions. Companies are not required to use any specific language or form for the resolution. The vote under Section 14A(b)(2) only relates to the disclosures required under Section 14A(b)(1) (i.e., if the target is soliciting shareholder approval, the Golden Parachute Compensation payable between it and its NEOs and the NEOs of the acquiring company, but not the Golden Parachute Compensation that is payable to its NEOs by the acquiring company).

An exception from the separate shareholder vote requirement is provided if disclosure of the Golden Parachute Compensation had been included in the executive compensation disclosure that was subject to a prior Say on Pay vote. For the exception to be applicable, however, the executive compensation disclosure subject to the Say on Pay vote would need to have included the new Item 402(t) disclosure—the existing Item 402(j) disclosure would not be sufficient. The exception is also only applicable to the extent that the same Golden Parachute Compensation previously subject to a Say on Pay vote remains in effect and the terms have not been modified subsequent to the Say on Pay vote. If the Golden Parachute Compensation has been modified or new arrangements are entered into, only the new or modified arrangements would be subject to the Say on Golden Parachute vote. In this instance, two tables would be provided, the first table would disclose **all** Golden Parachute Compensation (i.e., the table previously disclosed and subject to the Say on Pay vote modified to include the new or revised arrangements) and a second table would only disclose the new or revised arrangements.

Exequity Comment*: Although the new Item 402(t) disclosure is broader than what is required under existing Item 402(j), most companies already include a tabular disclosure and provide an aggregate total in their Item 402(j) disclosure (even though it is not required). To include de minimis perquisites or benefits or nondiscriminatory benefits will likely not be viewed as onerous. Accordingly, we expect some companies to opt to include the new Item 402(t) disclosure in their proxies that are subject to the Say on Pay vote, simply because it is not that difficult to do so and they might be able to avoid separate disclosure if there is a Proposed Transaction. However, how often companies will be able to utilize the exception when it comes time to vote on a Proposed Transaction remains to be seen (since many companies will have either modified or introduced new compensation arrangements since the most recent Say on Pay vote).*

Transition Matters

As discussed, the SEC's rules are proposed and unlikely to be finalized by the time some companies are required to issue their proxies. The SEC stated, however, that if the annual meeting takes place on or after January 21, 2011, any proxy statement relating to the annual meeting must include the Say on Pay and Say When on Pay separate resolutions regardless of whether rules are finalized.

To facilitate compliance with the new statute, the SEC is addressing the following first-year transition issues:

- A preliminary proxy statement will not be required.
- The form of proxy for a Say When on Pay vote may provide the choice between 1, 2, 3 years, or abstain by boxes using a single proxy ballot. If proxy service providers cannot reprogram their systems to allow for a vote among four choices, the proxy may offer a choice between 1, 2, or 3 years and proxies are not voted on the frequency if one of those choices is not selected.
- TARP participants do not need to include a Say When on Pay vote.

If you have any questions about this ***Client Alert***, please contact Robbi Fox ((847) 948-8655 or Robbi.Fox@exqty.com) or any of the following:

Mark Gordon	(925) 478-8294	Mark.Gordon@exqty.com
Edward Hauder	(847) 996-3990	Edward.Hauder@exqty.com
Jeff Hyman	(203) 210-7046	Jeff.Hyman@exqty.com
Lynn Joy	(847) 996-3963	Lynn.Joy@exqty.com
Stacey Joy	(847) 996-3969	Stacey.Joy@exqty.com
Chad Mitchell	(949) 748-6169	Chad.Mitchell@exqty.com
Perry Papantonis	(908) 849-4858	Perry.Papantonis@exqty.com
Jeff Pullen	(847) 996-3967	Jeff.Pullen@exqty.com
Dianna Purcell	(908) 849-4878	Dianna.Purcell@exqty.com
Bob Reilley	(908) 849-4857	Bob.Reilley@exqty.com
Dmitry Shmoys	(949) 748-6132	Dmitry.Shmoys@exqty.com
Mike Sorensen	(847) 996-3996	Mike.Sorensen@exqty.com
Jim Woodrum	(847) 996-3971	Jim.Woodrum@exqty.com
Ross Zimmerman	(847) 996-3999	Ross.Zimmerman@exqty.com

Illinois Office (Headquarters) – 1870 West Winchester Road, Suite 141 ● Libertyville, IL 60048
California Offices – 18201 Von Karman, Suite 460 ● Irvine, CA 92612
– 2840 Comistas Drive ● Walnut Creek, CA 94598
Connecticut Office – 108 Pine Ridge Road ● Wilton, CT 06897
New Jersey Office – 3 Werner Way, Suite 300 ● Lebanon, NJ 08833
www.exqty.com

You are receiving this ***Client Alert*** as a client or friend of Exequity LLP. This ***Client Alert*** provides general information and not legal advice or opinions on specific facts. If you did not receive this directly from us and you would like to be sure you will receive future ***Client Alert***s and our other publications, please click on the following link to add yourself to our subscription list: http://www.exqty.com/References/Subscribe.aspx. If you want to unsubscribe from our list, please click on "Manage Subscription" at the bottom of the e-mail sent to you.

PUB/CA/Proposed Rules-Dodd Frank Implementation