

## in focus

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**The Say on Golden Parachute Pay Shareholder Vote**

*The Dodd-Frank Act and recently adopted SEC rules require a shareholder advisory vote on golden parachute compensation in M&A and similar transactions. What is the real effect of this new requirement?*

The Dodd-Frank Act requires companies to conduct a periodic shareholder advisory vote to approve the executive compensation disclosed in the company's annual proxy statement (a "Say-on-Pay Vote"). A company must also conduct a shareholder advisory vote to approve golden parachute compensation arrangements disclosed in its merger proxy statement ("Golden Parachute Vote"). There is an exception to this requirement: a Golden Parachute Vote is not required if the golden parachute compensation was previously subject to a shareholder advisory vote.

Before Dodd-Frank was passed, companies were (and still are) required to disclose golden parachute arrangements in their annual proxy statements in accordance with Item 402(j) of Regulation S-K as part of their executive compensation disclosure. So does that mean that a company qualifies for the exception to the Golden Parachute Vote requirement if its golden parachute arrangements are disclosed as required by Item 402(j) and are thereby subject to the Say-on-Pay Vote?

In short, not necessarily. A shareholder vote to approve golden parachute compensation as disclosed in accordance with Item 402(j) does not alone satisfy the exception to the Golden Parachute Vote requirements, which requires companies to conduct a shareholder vote on golden parachute compensation as disclosed in accordance with the new Item 402(t) to Regulations S-K.

*How does Item 402(t) differ from Item 402(j)?*

Item 402(t) requires disclosure of golden parachute compensation in narrative form and in a table. In contrast, Item 402(j) does not require a tabular disclosure (although it is recommended). Further, while Item 402(j) allows exclusion of *de minimis* compensation (up to \$10,000) and compensation arrangements that are available generally to all salaried employees, Item 402(t) has no such exceptions and requires that all compensation be disclosed. Finally, to satisfy Item 402(t), companies must disclose the aggregate total of all compensation, while Item 402(j) has no such requirement.

The SEC has stated that a disclosure that satisfies Item 402(t) will also satisfy Item 402(j) so long as the disclosure includes payments that may be made to named executive officers upon termination of employment (a disclosure that is not required by Item 402(t)).

If a company discloses golden parachute compensation in its annual proxy statement in accordance with Item 402(t) and that compensation is subject to a shareholder advisory vote, then the company does not have to conduct a Golden Parachute Vote in its merger proxy statement. (The company must still make the disclosures required by Item 402(t) in the merger proxy statement.) Note that the golden parachute compensation need only be *subject* to a shareholder advisory vote to qualify for the exception; shareholders need not approve it. That begs the next question:

*Why should a company include the Item 402(t) disclosure in its annual proxy statements?*

There are several arguments in favor of including the Item 402(t) disclosures in the annual proxy statement, including:

- Shareholders are going to vote on golden parachute compensation in the annual proxy statement anyway (disclosed per Item 402(j)). By enhancing the disclosure to satisfy Item 402(t), the company can kill two birds with one stone, and will not be required to conduct Golden Parachute Vote in its merger proxy statement.
- Conducting a Golden Parachute Vote in connection with a corporate transaction will draw additional attention to these payments and may cause some shareholders to reject not only the golden parachute compensation, but also the transaction.
- Approval of the Item 402(t) golden parachute compensation in advance may be a favorable factor in support of approval of the transaction.
- The company may avoid negative publicity that can result from the golden parachute compensation payable in connection with a corporate transaction by receiving advance approval of the payments as part of its Say-on-Pay Vote.

However, there are arguments against including the Item 402(t) disclosures in the annual proxy statement, including:

- The Item 402(t) disclosure requirements may impose additional administrative burdens.
- Conducting a Golden Parachute Vote in connection with the shareholder vote on the transaction may allow shareholders who disapprove of the golden parachute compensation arrangements the ability to express this disapproval by voting to reject the arrangements (a vote that will have symbolic effect) without rejecting the entire transaction (a vote that will have tangible effect).

- The company may still have to conduct a Golden Parachute Vote if there are changes to the golden parachute compensation (such additional grants of equity or salary increases) since it was last subject to a shareholder vote.

There is also the question of whether there is any advantage to being consistent, *i.e.*, always excluding the Item 402(t) disclosure from the annual proxy statement or always including it. If the company did not previously satisfy Item 402(t) in its annual disclosures, will choosing to do so later cause investors to believe that the company seeks approval of the golden parachute compensation in advance of an as yet unannounced corporate transaction?

Further, what is the benefit to shareholders of an advisory vote on golden parachute compensation in the merger proxy statement? The vote is advisory, so the company is not legally required to do anything in response to the vote. In a corporate transaction, there might not be much the company can do, especially if the shareholders approve the transaction.

If the shareholders reject the executive compensation disclosed in the annual proxy statement, the company can make changes to that compensation, including the golden parachutes. However, if the shareholders reject the golden parachutes disclosed in the merger proxy statement and approve the transaction, the compensation will likely be paid with no opportunity for the company to change it. Especially if the transaction is one in which the shareholder base will change significantly, there may be no action for the company to take in response to the shareholder vote. The shareholder votes in these cases may be more instructive to other similarly-situated companies than of use to the company that actually conducted the shareholder vote or its shareholders.

Regardless of when companies choose to make their golden parachute compensation disclosures, it is clear that they will need to be prepared to face a good deal of scrutiny of these disclosures by investors and proxy advisory firms.

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