BURNS & LEVINSON LLP

SECURITIES LAW UPDATE

SEC Adopts "Say-on-Pay" Rules for Executive Compensation and Golden Parachutes; Proposes Amendments to "Accredited Investor" Standards

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On Jan. 25, 2011, the Securities and Exchange Commission (the "SEC") adopted new rules mandating periodic shareholder advisory votes on executive compensation and golden parachute arrangements for public companies. The SEC also created new disclosure requirements associated with golden parachute compensation related to all kinds of merger transactions.

These new rules were necessitated by the terms of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which we previously described in our July 2010 Securities Law Update entitled "Summary of Corporate Governance Changes in the Dodd-Frank U.S. Financial Regulatory Reform Act," and which can be found on our website at http://www.burnslev.com/apps/uploads/publications/Securities_Update_Dodd-Frank_July2010.pdf.

The new "say-on-pay" rules require publicly-held companies, beginning with shareholder meetings held on or after January 21, 2011, to do the following:

- conduct periodic shareholder advisory votes on executive compensation no less frequently than once every three years;
- conduct separate shareholder advisory votes regarding the desired frequency of advisory voting on compensation no less often than once every six years; and
- in some circumstances, conduct separate shareholder advisory votes on the approval of golden parachute arrangements.

Under the new rules, public issuers must also make disclosures pertinent to shareholder advisory voting on executive compensation, including:

- disclosures regarding the effect of shareholder advisory votes on company decisions regarding executive compensation;
- disclosures regarding the effect of shareholder advisory votes on company decisions regarding the frequency of advisory voting; and
- disclosures regarding the terms of golden parachute arrangements in connection with merger transactions by means of additional Compensation and Discussion Analysis ("CDA") discussion.

Certain checkmark choices that must appear in proxy forms associated with shareholder advisory voting on executive compensation have been spelled out in the new rules as well.

The rules are substantially similar to those proposed by the SEC on Oct. 18, 2010, although they include some modifications and clarifications that were made pursuant to more than 60 comment letters received by the SEC. (The rules, as originally proposed, were summarized in our update entitled "SEC Proposes Rules for Shareholder Voting on Executive Compensation and Golden Parachute Disclosure," which can be found on our Website at http://www.burnslev.com/apps/uploads/publications/Securities_Update_SEC_Golden_Parachute_Nov2010.pdf).

One of the key modifications that resulted from public comment was a 2-year exemption from "say-on-pay" voting requirements for smaller reporting companies (which are generally defined in Rule 12b-2 as having a float of less than $75 million as of the last day of their most recent second fiscal quarter). For those companies, "say-on-pay" advisory votes will be required at specified shareholder meetings only on or after January 21, 2013.

It is also worth noting that the SEC rejected public comments asserting that the Dodd-Frank Act made shareholder "say-on-pay" votes binding on public issuers. Thus, all pertinent shareholder votes are advisory only, unless a company chooses otherwise.

The following discussion provides a summary of the new rules related to shareholder voting on executive compensation, as well as a summary of proposed amendments to the standards for "accredited investors" that were also announced on January 25, 2011.

For a full copy of the SEC's "say-on-pay" rules, see SEC Release Nos. 33-9178, 34-63768 (the "Release") at http://www.sec.gov/rules/final/2011/33-9178.pdf. For a full copy of the SEC's proposed, revised "accredited investor" standards, see SEC Release No. 33-9177 at http://www.sec.gov/rules/proposed/2011/33-9177.pdf.

SHAREHOLDER APPROVAL OF EXECUTIVE COMPENSATION

Several new requirements were imposed on public companies that relate to shareholder advisory votes on executive compensation.

1. Rule 14a-21(a) on Executive Compensation Approval

Under new Rule 14a-21(a), public company issuers are required, at least once every three calendar years, to provide a shareholder advisory vote on the approval of executive compensation. The reference to "calendar" years is a clarification to the proposed rule, as is the provision that such shareholder votes on executive compensation must be conducted at "an annual meeting of shareholders at which proxies will be solicited for the election of directors, or a special meeting in lieu of such annual meeting."

A shareholder vote to approve the compensation of executives is now required for the first annual or special meeting of shareholders occurring on or after January 21, 2011.

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Pursuant to this rule, shareholders must be given the opportunity to vote in favor of or against the compensation plan for the issuer's named executives, based on the CDA, the compensation tables and other narrative executive compensation disclosures required in Item 402 of Regulation S-K. But the final rule does not require issuers to use any specific language or form of resolution for voting.

An instruction to Rule 14a-21 now clarifies that smaller reporting companies (those having a float of less than $75 million) are still subject only to scaled executive compensation disclosure requirements and are not required to include a CDA in their proxy materials.

As in the proposed rule, the compensation of directors is not subject to any shareholder advisory vote. The issuer's compensation policies and practices as they relate to risk management and risk-taking incentives are similarly not subject to approval; however, to the extent that risk considerations are a material aspect of the issuer's compensation policies for specific named executives, the issuer is required to discuss them as part of its CDA.

2. Disclosure Item 24 of Schedule 14A Re: the Effect of Voting on Compensation

Issuers are now required by rule to explain, whenever they are providing a separate shareholder vote on executive compensation, the general effect of that vote on compensation decisions, such as whether the vote will be non-binding. Pursuant to public comment, the SEC also added a requirement to disclose the current frequency of say-on-pay votes and the date of the next expected vote.

3. Amendments to Compensation Disclosure Item 402(b) of Regulation S-K

The SEC adopted an amendment to Item 402(b) of Regulation S-K that took into account certain public comments. The new rule requires issuers to address in their CDA whether and how their compensation policies and compensation decisions have taken into account the results of only *the most recent* shareholder advisory vote on executive compensation.

Smaller reporting companies are not required to include a CDA, and therefore are not required under the new rules to disclose how previous shareholder votes on compensation affected compensation decisions under Item 402(b).

SHAREHOLDER APPROVAL OF THE FREQUENCY OF EXECUTIVE COMPENSATION REVIEW

The SEC also issued a number of rules regarding the frequency with which shareholders must be given the opportunity to vote on executive compensation. New rules regarding ballot options and reporting on Form 8-K were announced as well.

1. Rule 14a-21(b) on Frequency of Review

Under this new rule, issuers are required to provide a separate shareholder advisory vote in proxy statements to determine whether shareholder voting on executive compensation should occur once every one, two or three years. This vote on frequency is required not less frequently than once every six years.

After considering and reviewing comments on the proposed rule, the SEC decided it was not necessary to provide a specific form of resolution for the Rule 14a-21(b) vote.

2. Item 24 of Schedule 14A Re: the Effect of Voting on Frequency

Issuers are now required to disclose in their proxy statements that they are providing separate shareholder advisory votes on the frequency of "say-on-pay" votes. Item 24 of Schedule 14A also requires issuers to briefly explain the effect of the shareholder vote on frequency, such as whether the vote will be non-binding.

After reviewing public comments, the SEC decided to also include a requirement under Item 24 for issuers to provide disclosure of the current frequency of "say-on-pay" votes and disclosure of when the next such vote will occur.

3. Amendments to Rule 14a-4 Re: the Voting Mechanism

This amended rule requires that issuers provide their shareholders with four ballot choices regarding advisory votes on executive compensation:

- whether the vote on compensation will occur every year;
- whether the vote on compensation will occur every two years;
- whether the vote on compensation will occur every three years; or
- whether the shareholder wishes to abstain from voting.

The proxy materials may include a recommendation as to how shareholders should vote, but the proxy card cannot limit shareholders to merely approving or disapproving of an issuer's recommendations.

Pursuant to public comment, the SEC has clarified that issuers may vote uninstructed proxy cards in accordance with management's recommendation for the "frequency vote" under certain circumstances. In order to do so, the issuer must follow existing requirements of Rule 14a-4 by including the following in its proxy materials: 1.) a recommendation on how to vote; 2.) a means to permit abstention from voting; and 3.) a set of clear disclosures in bold regarding how uninstructed shares will be voted (the latter two items to be more specifically included on the proxy cards).

4. Amendment to Rule 14a-8 Re: Excluding Certain Shareholder Proposals

Rule 14a-8 ordinarily provides eligible shareholders with an opportunity to include a proposal in an issuer's proxy materials for a vote at a meeting of shareholders; but the SEC has added a note to Rule 14a-8(i)(10) in order to permit the exclusion of any shareholder proposal that would provide a say-on-pay vote, seek a future vote on that subject, or seek a vote on frequency of executive compensation approval separate and apart from the voting provided for by the new rules.

However, pursuant to public comment, the SEC has decided that such an exclusion shall be permitted only if a single frequency of voting on compensation (every one, two or three years) has received a majority of shareholder votes under the new rules and the issuer has adopted a policy on frequency in accordance with that majority.

5. Amendments to Form 8-K

After reviewing public comments on its proposal to amend Form 10-K and Form 10-Q, the SEC decided instead to adopt new "say-on-pay" disclosure requirements through an amendment to Item 5.07 of Form 8-K.

This item now requires that issuers disclose, no later than 150 calendar days after the end of the relevant annual or special meeting of shareholders at which the Rule 14a-21(b)

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vote took place, but in no event later than 60 calendar days prior to the deadline for the submission of shareholder proposals under Rule 14a-8 for the subsequent annual meeting, any decision on the frequency of shareholder advisory voting on compensation following each shareholder vote on that subject.

6. Effect of Shareholder Votes Generally

New Item 24 to Schedule 14A mandates disclosure regarding the "general effect" of shareholder advisory votes on an issuer, such as whether a given vote would be binding.

ISSUES RELATING TO SHAREHOLDER VOTES ON COMPENSATION

The SEC also issued rules to clarify the answers to certain questions created by the new shareholder voting requirements pertinent to executive compensation.

1. Amendments to Rule 14a-6 Re: Preliminary Filings

Under longstanding rules, in certain situations issuers are required to file proxy statements with the SEC in preliminary form at least 10 calendar days before definitive materials are first sent to shareholders. Rule 14a-6 has been amended to indicate that shareholder votes on executive compensation and the frequency of compensation review do not in and of themselves trigger a preliminary filing.

2. Broker Discretionary Voting

Section 957 of the Dodd-Frank Act directed national securities exchanges to change their rules to prohibit broker discretionary voting of uninstructed shares in certain matters, including shareholder votes on executive compensation. The SEC noted that, in accordance with the latest rules of national securities exchanges, broker discretionary voting of uninstructed shares is now specifically prohibited for shareholder votes on executive compensation and the frequency of executive compensation review.

3. Special Issues for TARP Companies

Issuers that have received financial assistance under the Troubled Asset Relief Program ("TARP") are already required to conduct separate annual shareholder votes to approve executive compensation during the period in which any obligation to the government arising from TARP remains outstanding.

Consequently, the SEC, pursuant to Rule 14a-21(b), has exempted issuers with outstanding TARP indebtedness from compliance with the new rules. But this exemption applies to a given issuer only until it has repaid all TARP indebtedness.

DISCLOSURE OF AND APPROVAL OF GOLDEN PARACHUTES

In the past, issuers have been required to make certain disclosures about golden parachute arrangements, but they were not required to include detailed compensation information specifically applicable to proxy solicitations for merger or sale transactions.

Now, the SEC has amended Schedule 14A to require disclosure regarding golden parachute compensation in proxy or consent solicitations pertinent to acquisitions, mergers, consolidations, or proposed sales of substantially all assets of an issuer.

1. Broad Application of New Rules

Agreements or understandings between a target issuer conducting a proxy solicitation and its "named executive officers" are subject to new narrative and tabular disclosure requirements pursuant to Item 402(t).

The American Bar Association asked the SEC to clarify that the "named executive officers" subject to Item 402(t) are determined in the same manner as under Item 5.02(e) of Form 8-K, but the SEC did not specifically approve of or reject that idea. Instead, it issued Instruction 1 to Item 402(t), which requires disclosure for all individuals covered by Items 402(a)(3)(i), (ii) and (iii), and, for smaller reporting companies, the individuals covered by Items 402(m)(2)(i) and (ii).

Item 402(t) now requires, in the SEC's own words, "quantification with respect to any agreements or understandings, whether written or unwritten, between each named executive officer and the acquiring company or the target company, concerning any type of compensation, whether present, deferred or contingent, that is based on or otherwise relates to an acquisition, merger, consolidation, sale or other disposition of all or substantially all assets."

Rule amendments require Item 402(t) disclosure in many specified transactions, including mergers, acquisitions, and even Rule 13e-3 going-private transactions or tender offers. The rule thus potentially affects private acquirers and their officers.

2. Format for Golden Parachute Disclosures

Item 402(t) of Regulation S-K now requires disclosure of named executive officers' golden parachute arrangements in both tabular and narrative formats.

The disclosure table must separately quantify and list for each named executive:

- any cash severance payments;
- the dollar value of accelerated stock awards, in-the-money option awards, and payments in cancellation of stock and option awards;
- pension and nonqualified deferred compensation benefit enhancements;
- perquisites and other personal benefits, plus any health and welfare benefits;
- tax reimbursements; and
- other compensation not specifically covered in the table's other columns.

Pursuant to public comments, the SEC has also mandated separate footnote identification of amounts attributable to "single trigger" arrangements (predicated only on change in control) and "double trigger" arrangements (predicated also on termination of executive employment without cause or executive resignation within a limited period of time after change in control).

The SEC added that affected issuers must also disclose in narrative form "the specific circumstances that would trigger payment, whether the payments would or could be lump sum, or annual, and their duration, by whom the payments would be provided, and any material factors regarding each agreement."

Issuers are also permitted to provide disclosure for additional named officers and to provide additional columns or rows to their tabular disclosures, so long as such disclosure is not confusing or misleading.

The SEC emphasized that Item 402(t) does not permit exclusion of de minimus perquisites and other personal benefits.

However, Item 402(t) requires tabular and narrative disclosure only for compensation that is based on or otherwise relates to the

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specific merger or sale transaction in connection with which proxies are to be sought. The item also does not apply to "bona fide post-transaction employment agreements" according to the Release.

3. Other Amendments to Various Disclosure Schedules

The SEC has required Item 402(t) disclosure not only in proxy or consent solicitations, but also in the following items:

- 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; and
- going private transactions on Schedule 13E-3.

In response to public comments, the SEC also adopted an amendment to Schedule TO providing that bidders in third-party tender offers are not required to provide the disclosures required by Item 1011(b) of Regulation M-A (related to golden parachutes).

The SEC also adopted an exception to the disclosure obligations of Item 402(t) for agreements and understandings with senior management of foreign private issuers where either the target or the acquirer is a foreign private issuer (consistent with longstanding accommodations to foreign private issuers).

4. Rule 14a-21(c) Re: Shareholder Votes on Transactional Golden Parachutes

Under Rule 14a-21(c), issuers are now required to provide a separate shareholder advisory vote in proxy statements for meetings at which shareholders are asked to approve an acquisition, merger, consolidation or sale of all or substantially all assets of the issuer. The vote is required only with respect to golden parachute arrangements or other understandings required to be disclosed by Section 14a(b)(1) in the form specified by new Item 402(t).

This shareholder vote is not binding on the issuer or its Board of Directors, and issuers are not required to include disclosure regarding compensation that had been included in executive compensation disclosures subject to a prior vote under Section 14A(a)(1) of the Exchange Act and Rule 14a-21(c) (provided that the compensation disclosure subject to the prior vote would have included Item 402(t) disclosure of the same golden parachute arrangements or other prior arrangements of even greater value).

TREATMENT OF SMALLER COMPANIES

While smaller companies (as defined by Rule 12b-2) are exempt from the CDA enhancements applied to other public companies, they are still subject to the rules regarding "say on pay" votes, voting on the frequency of executive compensation review, and golden parachute disclosures and votes.

However, the SEC has adopted a temporary exemption for smaller reporting companies so that they will not be required to conduct shareholder advisory votes on executive compensation or on the frequency of "say-on-pay" votes until their first annual or special meeting of shareholders occurring on or after Jan. 21, 2013.

There is no such temporary exemption pertinent to shareholder advisory votes on golden parachute arrangements.

TRANSITIONAL MATTERS

Since some proxy service providers are currently equipped to provide only three fields for voting options (yes, no and abstain), the SEC will temporarily refrain from objecting if the proxy card for a shareholder vote on frequency of compensation review were to contain only options for voting on one, two or three year reviews with no option for abstention (provided that issuers assert no discretionary authority to vote the unmarked proxies in those situations).

This temporary suspension of objections shall apply only to proxy materials filed for meetings to be held on or before Dec. 31, 2011.

CHANGES TO "ACCREDITED INVESTOR" STANDARDS

In a separate release, the SEC proposed the adjustment of the net worth standard for "accredited investors" so that their primary residence will no longer be included in calculations of their net worth, pursuant to Section 413(a) of the Dodd-Frank Act. The revised standard for accredited investors has been in place under Dodd-Frank since July 2010, with the SEC definitional change being made so that the SEC's rules are consistent with Dodd-Frank requirements.

The "accredited investor" standard defines those investors of presumed sufficient economic sophistication to whom issuers may sell securities in specified private and limited offerings without the necessity of registration of such offerings under the Securities Act of 1933. There are several standards under which an individual can be deemed to be an "accredited investor," one of which is a net worth test. Under the old net worth test, the value of an individual's primary residence could be included.

The new net worth definition of an "accredited investor," as amended, is as follows:

> "any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of purchase, exceeds $1 million, excluding the value of the primary residence of such natural person, [which must be] calculated by subtracting from the estimated fair market value of the property the amount of debt secured by the property, [only] up to the estimated fair market value of the property."

This language effectively clarifies that an accredited investor's net worth is calculated by excluding only the net equity of the primary residence, insuring that any indebtedness secured by the property in excess of the fair market value of the residence is a liability for purposes of calculating total net worth.

In the release, the SEC added that "issuers and investors should be able to use the commonly understood meaning of 'primary residence' - the home where a person lives most of the time."

The SEC solicited public comments on a number of specific topics related to this proposal, including:

- comments as to whether the proposed amendments should also contain a timing provision in order to prevent investors from inflating their net worth by purchasing assets with the proceeds

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of indebtedness secured by their homes with intent to qualify as accredited investors; and

- comments on whether transitional rules should be adopted providing that an investor who previously qualified as an accredited investor before enactment of the Dodd-Frank Act may continue to so qualify for the limited purpose of "follow-on" investments to protect their rights or economic interests.

Any public comments on this proposal must be received by the SEC on or before March 11, 2011 in order to be considered.

Explanatory Notes:

This update is intended to call your attention to a number of rule changes of possible interest and relevance, but it is not intended to constitute a legal opinion or definitive summary of all changes that could be material to you.

Please contact a member of the Securities Law Group at Burns & Levinson if you have any questions about these potential rule changes or if you want to learn more about our expertise in this area.

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