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EBEC (Employee Benefits / Executive Compensation) Law Update

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**EXECUTIVE COMPENSATION PROVISIONS OF DODD-FRANK
WALL STREET REFORM AND CONSUMER PROTECTION ACT OF 2010**

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, P.L. 111-203, H.R. 4173, signed July 21, 2010 (“Dodd-Frank Act” or “Act”), contains say-on-pay and other shareholder-accountability executive compensation proxy rules.

1. Say-on-Pay. Section 951 of Dodd-Frank Act adds new § 14A(a) (15 USC §78n-1(b)) to the Securities Exchange Act of 1934 that a non-binding shareholder vote on executive compensation must be held every 1,2 or 3 years (with frequency elected in a separate shareholder vote at least once every 6 years).

The “say-on-pay” vote is on compensation of named executive officers as disclosed in the executive compensation disclosure of the proxy.

The say on pay vote is non-binding – it is advisory only – and it does not create any additional fiduciary duties. Previously, optional say on pay votes required a preliminary proxy. A preliminary proxy will not be required for mandatory say on pay vote, according to proposed rules as discussed below.

2. Say-On-Golden Parachutes. Section 951 of the Dodd-Frank Act adds § 14A(b) to the Securities Exchange Act that a proxy or consent solicitation with a shareholder vote to approve a transaction, requires disclosure and a separate non-binding vote for any agreements with named executive officers relating to compensation (present, deferred or contingent) that is based on or relates to an acquisition, merger, consolidation, sale or other disposition of substantially of all the assets (“golden parachutes”) and the total of such compensation that may be paid out.

3. Effective Date. The various shareholder vote requirements such as say on pay, frequency of vote and say on golden parachute become effective on the first shareholder meeting occurring on or after January 21, 2011 (6 months after enactment of Dodd-Frank Act). No rulemaking is required to trigger the effective date.

4. Proposed Regulations on Say-on-Pay. The SEC released proposed rules and amendments to rules relating to the above say-on-pay and say-on-golden parachute requirements of the Dodd-Frank Act. 17

CFR Parts 229, 240 and 249, 75 Fed. Reg. 66590 (Oct. 28, 2010). (All references below to regulations are to these proposed regulations and proposed amendments to regulations.)

- a. Annual Proxies. Say-on-Pay is only required in proxies for election of directors.
 - b. Say on all NEO 402 Pay. Vote of say-on-pay is for all Item 402 compensation for named executive officers (including CD&A, tables are other narrative disclosure under Item 402 Rule 14(a)-21(a), 17 CFR § 240-14a-21(a). This vote is not required for director compensation.
 - c. Vote. The vote is on approval of compensation of executives as disclosed under Item 402 of Reg. S-K.
 - d. Vote on Frequency of Say-on-Pay Vote. Choice of voting frequency is one year, two years or three years (and shareholder can also abstain). Rule 14a-21(b).
 - e. No Preliminary Proxy. No preliminary proxy is required for shareholder say-on-pay vote or frequency vote. Rule 14a-6(a).
 - f. Compensation Discussion & Analysis. Item 402(b) is changed so that disclosure is required in CD&A as to whether and how the company's compensation policy takes into account the prior say on pay vote.
5. Proposed Regulations on Say on Golden Parachute. These proposed rules also govern say on golden parachutes.
- a. Separate Vote in Transaction Proxy. Proposed rules provide that in a proxy or consent solicitation to approve an acquisition, merger, consolidation or sale of substantially all of assets, a separate shareholder vote is required to approve any type of compensation (whether present, deferred or contingent) that is based on or relates to the transaction. 17 CFR § 240.14a-21(c) & § 229.402(t)(1)
 - b. Separate Golden Parachute Vote Not Required if Already Approved in Annual Proxy. The vote on golden parachutes is not required if such golden parachutes were already approved in the regular annual (or bi or tri-annual) proxy vote assuming the applicable 402(t) golden parachute chart has been included in the annual proxy. 17 CFR § 240.14a-21.
 - c. Golden Parachute Table. Golden parachute compensation disclosure, where required, shall include under proposed Item 402(t) a golden parachute compensation table with the named executive officers and the dollar value of cash severance, accelerated stock options, and other stocks awards, payments in cancellation of such awards, pension and deferred compensation benefit enhancements, prerequisites, tax reimbursements (such as 280G gross-ups) and other personal benefits, and any other compensation payable on account of the transaction. 17 CFR § 229.402(t).
 - d. Footnotes to Golden Parachute Table. Footnote should disclose each separate form of compensation and shall indicate if it is a single trigger or a double trigger. Even change in control compensation from broad-based plans must be disclosed to the extent it affects the named executive officers.
 - e. Narrative Golden Parachute Disclosure. Item 402(t)(3) requires narrative description of material factors applicable to the change in control payments in the chart, including conditions of payment, form of payment, noncompetes and confidentiality agreements.

6. Recovery of Erroneously Awarded Compensation – Expanded Clawbacks. Section 954 of the Dodd-Frank Act adds securities Exchange Act § 10D, which instructs the SEC to direct the listing exchanges to require of the listed companies:

a. Disclosure of the company’s policy regarding incentive compensation based on reported financial information; and

b. Recoupment (clawback) from any current or former executive officer of any incentive compensation paid during the past three years based on erroneous data if the company is required to restate the financials; the recoupment is for the excess of the amount of incentive compensation paid based on the erroneous financial information over what would have been payable under the corrected financial information.

Note that the Dodd-Frank Act clawback is broader than the Sarbanes-Oxley Act clawback in that under Dodd-Frank it applies to erroneous information whether or not there was misconduct, it goes back three years instead of 12 months and it applies to all executive officers not just named executive officers.

7. Compensation Committees and Compensation Consultant are Advisor Independence.

a. Compensation Committee Independence. Section 952 of Dodd-Frank Act adds §10C(a) of the Securities Exchange Act instructing stock exchanges to require that listed companies have compensation committee members who are Board members and are also “independent”. The respective stock exchanges will define independent considering compensation paid to the committee members (e.g. consulting or advisory fees) and whether the committee member is affiliated with the company.

A compensation consultant or other advisor may be selected only after the compensation committee has taken into account relevant factors determining independence including: (i) provision of other services to the company by the entity that employs the consultant or advisor; (ii) fees received from the company as a percentage of the total revenue of the entity that employs the consultant or advisor; (iii) policies of the entity employing the consultant or advisor; (iv) any business or personal relationship between the compensation committee and the consultant or advisor; and (v) any stock of the company owned by the compensation consultant or advisor.

b. Authority to Retain Compensation Consultants and Advisors. Section 952 also adds Securities Exchange Act §§ 10C(c) and (d) that a compensation committee may in its sole discretion retain a compensation consultant legal counsel or other advisors. The compensation committee will be directly responsible for appointment, compensation and oversight of the work of the consultant or advisor. (The annual proxy must disclose whether the compensation committee has engaged a compensation consultant and whether there are any conflicts of interest.)

c. Funding Section 10C(e) provides that the company shall provide appropriate funding for reasonable compensation of the committee’s compensation consultant and advisors.

d. Requirement of Listing Companies and Effective Date. The Dodd-Frank Act provides that the SEC must adopt rules by 360 days after enactment (July 16, 2011) providing that securities exchanges shall prohibit security listing by companies not in compliance with these compensation consultant & advisor rules. § 10C(f).

8. Hedging Disclosure. The proxy must contain a policy regarding permissibility of employees or directors purchasing derivatives to hedge against equity grants. Section 955 of Dodd-Frank Act adding § 14(j) of the Securities Exchange Act.

9. Joint or Separate CEO & Chairman. Under § 972 of the Dodd-Frank Act rules are to be issued within 180 days of enactment (Jan. 17, 2011) requiring listed company proxies to disclose why CEO and Chairman are the same person or two separate people.

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