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IN THIS ISSUE:

- Office Depot and Executives Pay Civil Penalties for Selective Disclosures to Analysts
- SEC Proposes Rules to Guide Implementation of "Say-On-Pay"

OFFICE DEPOT AND EXECUTIVES PAY CIVIL PENALTIES FOR SELECTIVE DISCLOSURES TO ANALYSTS

On October 21, the Securities and Exchange Commission announced that Office Depot and two executives agreed to pay over $1 million in civil penalties to settle a complaint filed in federal district court alleging that the company violated securities laws by making selective disclosures to analysts in June 2007. As a part of the settlement, Office Depot and the two executives, Chairman and CEO Stephen Odland and former CFO Patricia McKay, without admitting or denying the SEC's findings or allegations, consented to the entry of administrative orders requiring them to cease and desist from committing any such violations and future violations.

The cease-and-desist orders charged that Odland and McKay improperly encouraged Office Depot's Director of Investor Relations to suggest to securities analysts that the company would not meet its earnings expectations for the second quarter of 2007. Neither Odland nor McKay, who each agreed to pay the SEC a $50,000 civil penalty, was present at the time of the selective disclosures. On Monday, October 25, Office Depot announced that Odland will resign as Chairman and CEO effective November 1.

In a series of telephone conversations with securities analysts, Office Depot's Director of Investor Relations discussed the slow growth described in recent earnings statements of similar companies and reiterated cautionary public statements made by Office Depot during the second quarter of 2007. These telephone conversations prompted most analysts to lower their second quarter forecasts. Six days after the first of these telephone calls, Office Depot filed a Form 8-K publicly disclosing that its earnings would be lower than expected. The SEC alleged that these actions violated Section 13(a) of the Securities Exchange Act of 1934 and Regulation FD (Fair Disclosure).

Regulation FD prohibits selective disclosure of non-public information by public relations professionals or senior officials of an issuer to securities market professionals, and to shareholders when it is reasonably foreseeable that they will trade on the information. If a company unintentionally discloses material non-public information to such persons, Regulation FD requires that the company disclose the information on a Form 8-K or other prescribed method of public distribution within 24 hours, or by the commencement of the next day's trading, if later. An intentional disclosure of material non-public information to such persons must be simultaneously disclosed to the public. Failure to make a public disclosure required by Regulation FD constitutes a violation of both the Regulation and Section 13(a) of the Securities Exchange Act of 1934.

As the *Office Depot* case demonstrates, any private discussion with securities market professionals regarding a company's projected earnings is risky under Regulation FD. The SEC charged Office Depot and its executives with a violation even though the company made no direct statement about its second-quarter earnings. Rather, by discussing with analysts publicly available information about adverse market trends, Office Depot implied that it would not meet expectations. Creating this implication, the SEC charged, was an improper selective disclosure of material non-public information.

Further, the *Office Depot* case demonstrates the importance of cultivating an environment of compliance. In a 2009 case, the SEC declined to file an enforcement action against American Commercial Lines, Inc. after the company's CFO sent an e-mail to eight analysts stating that the company's earnings per share would likely be lower than expected. While the SEC filed a civil action against the CFO, it did not bring one against the company because it (1) provided Regulation FD training and adopted polices to prevent violations, (2) publicly disclosed the material information the same day it became aware of the disclosure, self-reported the incident to the SEC staff and cooperated with the SEC's investigation and (3) took remedial measures to prevent such conduct in the future.

Earlier this year, the SEC considered similar remedial measures and policies in a settlement of a Regulation FD enforcement action with Pressek, Inc. However, Office Depot, as the SEC noted in its complaint and cease-and-desist orders, lacked significant Regulation FD training or policies.

The *Office Depot* case highlights two important lessons about Regulation FD. The first is that senior officials and public relations representatives should proceed with caution in any private conversation with a securities market professional about future earnings to avoid directly or impliedly disclosing material non-public information. Second, companies that adopt training programs and policies specifically designed to educate company officials about Regulation FD can help protect themselves against SEC enforcement action in the event an officer acting without authority violates Regulation FD.

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SEC PROPOSES RULES TO GUIDE IMPLEMENTATION OF "SAY-ON-PAY"

On October 18, 2010, the SEC issued proposed rules to guide implementation of the shareholder advisory votes on executive compensation enacted as a part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). We discussed the statutory requirements in our July 2010 E*bulletin.

Under the Dodd-Frank Act, each public company is required to provide its shareholders three types of non-binding, advisory "say-on-pay" votes:

(1) at least every three years, a general *say-on-pay vote* to approve the company's executive compensation as disclosed under Item 402 of Regulation S-K;

(2) at least every six years, a say-on-pay *frequency vote*, to determine how often the general say-on-pay vote will occur; and

(3) in any proxy or consent solicitation seeking approval for a proposed merger, acquisition, consolidation, sale, or other transaction, a *say-on-golden parachutes* vote on compensation arrangements with the soliciting issuer's named executive officers (or, if the soliciting issuer is not the acquirer, with the acquirer's named executive officers) that would be triggered by, or otherwise relate to, the transaction, unless those arrangements have already been subject to a say-on-pay vote.

The say-on-pay and frequency votes are effective for meetings occurring on or after January 21, 2011. The say-on-golden parachutes vote will not become effective until final rulemaking, which is anticipated to occur in the first quarter of 2011.

The SEC has issued transition guidance for those issuers that must file and print proxy materials prior to final rulemaking, as discussed below under "Comment Period, Transition Guidance, and Rulemaking Timeline."

In addition, the Dodd-Frank Act requires each institutional investment manager subject to Section 13(f) of the Securities Exchange Act of 1934 (the "Exchange Act") to report annually how it voted on these say-on-pay matters. The SEC has issued proposed rules on this new reporting requirement simultaneous with the say-on-pay rule proposal.

This E*bulletin summarizes the SEC's proposed rules relating to these say-on-pay provisions of the Dodd-Frank Act.

The "Say-on-Pay" and "Say-on-Pay" Frequency Votes

When Required. As required by the Dodd-Frank Act, each public company must provide its shareholders a general say-on-pay vote and a say-on-pay frequency vote in its proxy statement for its first annual meeting on or after January 21, 2011. After this first proxy statement, an issuer must include in its proxy a say-on-pay vote at least every three years and a say-on-pay frequency vote at least every six years. These votes must be included in proxy statements that provide for the election of directors and that include mandatory executive compensation disclosure under Item 402 of Regulation S-K. Under the SEC's proposal, the inclusion of either the say-on-pay or the frequency vote in an issuer's proxy statement would not itself trigger the need for the issuer to file a preliminary proxy statement.

The Say-on-Pay Vote – Scope, Contents, and Future Disclosure. The SEC is not proposing specific proxy statement language to implement the say-on-pay vote. Rather, the SEC proposal indicates that the say-on-pay vote should seek approval of the compensation of the company's named executive officers as disclosed under Item 402 (which includes the Compensation Discussion and Analysis ("CD&A"), the compensation tables, and accompanying narrative compensation disclosures). The SEC has indicated that a general resolution seeking shareholder approval of the company's "compensation policies and procedures" would be insufficient to satisfy the say-on-pay vote requirement.

Under the proposed rules, an issuer must (a) disclose that it is providing a separate shareholder vote on executive compensation and (b) explain briefly the general effect of the vote (such as that the vote is non-binding and advisory in nature).

The say-on-pay vote does not relate to director compensation (Items 402(k) and 402(r)) or disclosure regarding risk management of compensation (Item 402(s)), unless the issuer is required to discuss the latter in the CD&A because it is a material aspect of the issuer's executive compensation policies or decisions.

The SEC is also proposing an amendment to Item 402 to require an issuer to address in its CD&A whether, and if so, how, its compensation policies and decisions have taken into account the results of previous shareholder advisory votes on executive compensation.

Smaller reporting companies, which are subject to scaled disclosure requirements (for example, they are not required to include a CD&A), are still required to provide shareholders with a say-on-pay vote, which should cover all of the Item 402 executive compensation subparts that are applicable to them.

The Say-on-Pay Frequency Vote – Scope, Contents, and Future Disclosure. The frequency vote is a nonbinding vote on how often the issuer should include the say-on-pay vote in its proxy materials. The SEC is proposing that issuers be required to give their shareholders four choices – a say-on-pay vote every one year, every two years, every three years, or to abstain from voting. As with the say-on-pay vote, an issuer must disclose in its proxy statement that it is providing a separate shareholder vote on the frequency of shareholder voting on executive compensation and explain briefly the general effect of the vote (such as that it is nonbinding). The SEC expects that issuers will recommend one of the four options, but notes that if an issuer does make such a recommendation, it must make clear that the frequency vote is not a vote to approve or disapprove that recommendation.

In addition, the SEC is proposing that an issuer publicly disclose its decision regarding how frequently it will hold a say-on-pay vote in light of the results of the frequency vote. Such disclosure would be included in the company's Form 10-Q for the period during which the vote was taken or the Form 10-K, if the vote was taken in the fourth quarter.

Impact on Shareholder Proposals. Under the SEC's proposed rules, if an issuer (1) adopts a policy on the frequency of say-on-pay votes consistent with the choice of a plurality of votes cast in the most recent frequency vote and (2) provides a say-on-pay frequency vote at least once every six years, then the company is expressly permitted to exclude as substantially implemented any shareholder proposals seeking an advisory say-on-pay vote or relating to the frequency of the say-on-pay vote.

Applicability to TARP recipients. Recipients of funds from the U.S. Department of the Treasury's Troubled Assets Relief Program ("TARP") are already required to provide their shareholders with an annual say-on-pay vote. The SEC's proposed rules provide that public companies that are TARP recipients will not be subject to these new say-on-pay and say-on-pay frequency votes until they have repaid all TARP indebtedness.

"Say-on-Golden Parachutes"

When Required. Under the Dodd-Frank Act, in connection with shareholder approval of an acquisition, merger, consolidation, or proposed sale or disposition of all or substantially all of a company's assets, the soliciting issuer is required to disclose all compensation-related agreements or understandings (written or unwritten) that it has with its named executive officers with respect to compensation that is based on or otherwise relates to the transaction. If the soliciting issuer is not the acquirer in the transaction, then it must also disclose all such agreements it has with the acquirer's named executive officers.

In addition to this disclosure, the soliciting company is required to provide its shareholders with a separate advisory vote on these compensation arrangements, unless all such arrangements were subject to a previous say-on-pay vote. However, if the soliciting company is the target, compensation arrangements between the acquirer and the target's named executive officers are not subject to the say-on-golden parachutes vote.

This say-on-golden parachutes disclosure and vote requirement will not take effect until after final rulemaking (expected in the first quarter of 2011).

Scope of Disclosure. The SEC's proposed rules would require broader disclosure than required by the Dodd-Frank Act. Under proposed new Item 402(t) of Regulation S-K, the soliciting company must disclose all transaction-related arrangements that either the target or the acquirer has with any of the named executive officers of either company. Proposed Item 402(t) differs slightly from what is currently disclosed in the proxy statement under Item 402(j) (disclosure of change-in-control and post-termination arrangements) in that Item 402(j) permits the omission of arrangements that do not discriminate in favor of the executives and de minimis amounts of perquisites and other personal benefits. In addition, proposed Item 402(t) requires a table ("Golden Parachute Compensation") and an aggregate total of all included compensation.

Proposed Item 402(t) would require separate quantification of the values of each of the following in a table: (1) any cash severance (including base salary, bonus, and pro-rata non-equity incentive plan compensation payments); (2) the dollar value of accelerated stock awards, in-the-money option awards for which vesting would be accelerated, and payments in cancellation of stock and option awards, (3) any enhancements to pension and non-qualified deferred compensation benefits; (4) perquisites (even if de minimis) and other personal benefits and health and welfare benefits (including any that do not discriminate in favor of executives); (5) tax gross-ups; (6) all "other" elements of compensation not specifically included; and (7) the total of all these amounts.

The proposed rules would also require footnotes disclosing which amounts are single-trigger (vest upon change in control only) and which are double-trigger (vesting requires change in control plus another event, such as termination of

employment). The issuer would also be required to describe in narrative format any material conditions or obligations to the receipt of these payments or benefits (for example, restrictive covenants, their duration, and any provisions permitting their waiver), specific circumstances triggering payment, whether payments would be lump sum or annual, the duration of the payments, who would be responsible for the payments, and any other material factors regarding each agreement. The issuer would not be required to include previously-vested equity awards, amounts already disclosed in either of the Pension Benefits or Non-Qualified Deferred Compensation tables, or compensation arrangements covering post-transaction employment that would be entered into in connection with the closing of the transaction (although these may be required to be disclosed separately under current Item 5 of Schedule 14A).

Scope of Vote; Exception for "Prior Say-on-Pay Vote." The say-on-golden parachutes vote would seek shareholder approval of the compensation arrangements disclosed under proposed Item 402(t), excluding any compensation arrangements between the acquirer and the target's named executive officers if the soliciting issuer is not the acquirer. Although the disclosure would be mandatory in any transaction-related proxy statement, the soliciting issuer would be permitted to omit the say-on-golden parachute vote provided the arrangements were subject to a prior advisory vote by shareholders. The SEC proposes that, in order to rely on this exception, the issuer would have had to voluntarily include information that satisfies new Item 402(t), in lieu of existing Item 402(j) disclosure, in its proxy statement that included the general say-on-pay vote. Of course, even if an issuer elects to incorporate Item 402(t) disclosure in its proxy statement, it still must comply with 402(j) rules as they relate to termination of employment outside a change in control scenario. In addition, if the "golden parachute" arrangements are new or have been revised since the earlier say-on-pay vote, the issuer cannot rely on this exception. If the issuer is excluding some of the disclosed compensation arrangements from consideration in its say-on-golden-parachutes vote, the issuer is required to report those in a second, separate Item 402(t) table.

Reporting of Say-on-Pay Votes Cast by Section 13(f) Institutional Investors

The SEC also proposed rules requiring that institutional investment managers subject to Section 13(f) of the Exchange Act file an annual report with the SEC to disclose their votes on any say-on-pay, say-on-pay frequency, or say-on-golden parachutes proposals.

The entities subject to Section 13(f) generally consist of persons with greater than $100 million of publicly-traded U.S. equity securities under management. Under current SEC rules, Section 13(f) entities that are investment companies are already required to disclose annually how they voted on all shareholder matters, but the Dodd-Frank Act expands the types of Section 13(f) entities required to make such reports to include hedge funds and other large shareholders, at least in the area of the say-on-pay votes.

The SEC's proposed rules would require each Section 13(f) entity to identify the securities voted, describe the matters up for vote, identify how the securities were voted, and state whether the vote was in line with management's recommendation. The annual report would be due by August 31 each year, covering the twelve-month period just ended on June 30. If adopted as proposed, Section 13(f) entities would be required to file their first report by August 31, 2011,

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October 2010 Vol. 88 corporateandsecurities@joneswalker.com

covering votes cast between January 21, 2011 (the effective date for the general say-on-pay and frequency votes) and June 30, 2011.

Comment Period, Transition Guidance, and Rulemaking Timeline

The SEC will accept comments on both sets of proposed rules through November 18, 2010, and has indicated that it anticipates adopting final rules in the first quarter of 2011. We will issue an E*bulletin on the final rules once the SEC has released them.

A company that will need to file its proxy statement prior to the issuance of the SEC's final say-on-pay rules is still required by the Dodd-Frank Act to include the say-on-pay and frequency votes in its proxy statement for its first annual meeting on or after January 21, 2011. In this case, the SEC has indicated that inclusion of these items alone will not require that the issuer file a preliminary proxy statement. Further, if the issuer's proxy service provider is unable to program its system to accommodate the new four-option answer to the say-on-pay frequency vote (i.e., one year, two years, three years, or abstain) prior to commencement of voting, then the company may omit the "abstain" option, but it cannot exercise discretion to vote the shares in favor of the frequency recommended by the company in the case of a proxy returned with none of the three choices selected.

It appears unlikely that any of the other executive compensation or corporate governance provisions in the Dodd-Frank Act will be effective for the 2011 proxy season. Although, according to the SEC's draft rulemaking schedule, the agency anticipates issuing proposed rules on some of the other executive compensation and corporate governance provisions of the Dodd-Frank Act before the end of 2010, their earliest estimated date for final rulemaking on any of these other items is not until April 2011.

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Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues, contact:

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