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SEC Issues Final Rules and Interpretive Guidance on Say-on-Pay and Say-on-Frequency Advisory Votes

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On January 25, 2011, the SEC adopted final rules to implement the say-on-pay and say-on-frequency advisory votes required by Section 951 of the Dodd-Frank Act. On February 11, 2011, the SEC Staff issued new Compliance and Disclosure Interpretations (CDIs) providing guidance about these votes. The new rules and related SEC Staff guidance are described below.

The new rules also implement the say-on-parachutes advisory vote required by Section 951 of the Dodd-Frank Act. Companies soliciting votes to approve a merger or acquisition transaction will be required to disclose "golden parachute" compensation arrangements and, in certain circumstances, to propose a separate stockholder advisory vote to approve the arrangements. The say-on-parachutes advisory vote is required in proxy statements and other schedules and forms in connection with merger transactions initially filed on or after April 25, 2011.

Say-on-Pay

Under the final say-on-pay rules, companies must propose a separate resolution subject to stockholder advisory vote at least once every three calendar years to approve the compensation of the named executive officers, as disclosed pursuant to Item 402 of Regulation S-K.

The say-on-pay vote:

- covers all of Compensation Discussion and Analysis (CD&A), the compensation tables and the narrative compensation discussion provided pursuant to Regulation S-K Item 402;
- does not cover director compensation; and
- does not cover disclosure pursuant to Regulation S-K Item 402(s), related to compensation policies and practices for employees that are reasonably likely to have an adverse material effect on the company. (If risks arising from compensation policies are discussed as a part of CD&A, however, that discussion will be covered by the say-on-pay vote, because it is part of the CD&A disclosure.)

The final rules do not prescribe specific language or a specific form of resolution for the say-on-pay

advisory vote. The SEC, however, has provided companies with a non-exclusive sample form of wording:

> "RESOLVED, that the compensation paid to the company's named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion is hereby APPROVED."

New CDI 169.05 permits companies to substitute plain English wording for "pursuant to Item 402 of Regulation S-K" in this sample resolution, such as:

> "pursuant to the compensation disclosure rules of the Securities and Exchange Commission, including the compensation discussion and analysis, the compensation tables and any related material disclosed in this proxy statement."

In future years, the new rules require CD&A to describe whether and, if so, how the company considered the results of the most recent say-on-pay vote in determining compensation policies and decisions and how that consideration has affected executive compensation decisions and policies. The rule release also expresses the SEC's view that companies must use CD&A to address their consideration of earlier say-on-pay votes to the extent such consideration is material to a company's compensation policies and decisions. The final rules declined to adopt the suggestion of some commentators that CD&A disclosure about consideration of say-on-pay votes would only be required if it was material under a company's individual facts and circumstances.

Say-on-Frequency

The final say-on-frequency rules require companies to allow stockholders to cast an advisory vote at least once every six calendar years regarding whether say-on-pay votes should occur every 1, 2 or 3 years. Under the say-on-frequency rules:

- stockholders must be given the option to abstain from the vote; and
- all four choices must be presented (1, 2 or 3 years or abstain); companies are not allowed to present an up-or-down vote on a single choice or to present other voting variations such as ranking the choices. Companies must make it clear that stockholders are not voting to approve or disapprove a single recommendation.

The rule release recognizes that the computer systems of some proxy service providers may be unable to immediately process the four separate say-on-frequency choices. In cases where a company's proxy service provider is only able to process three choices, the rule release provides that the SEC will not object to the presentation of the options 1, 2 or 3 years, with "abstain" omitted. This transition provision is available for proxy materials filed for meetings to be held on or before December 31, 2011.

The final rules do not prescribe a form of resolution for the say-on-frequency vote, and new CDI 169.04 clarifies that no formal resolution need be proposed at all. New CDI 169.06 also provides

flexibility for the wording of the vote, allowing it to include the words “every year, every other year, or every three years, or abstain” instead of the words, “every 1, 2, or 3 years, or abstain.”

The rule release clarifies that despite Section 951 of the Dodd-Frank Act referring to the say-on-frequency vote being to “determine” the frequency of future say-on-pay votes, the SEC views the statutory rules of construction included in Section 951 as indicating the vote is advisory.

Companies may vote uninstructed proxy cards in favor of the board’s say-on-frequency recommendation, but only if:

- the proxy describes the board’s recommendation;
- the company is presenting all four options (1, 2 or 3 years or abstain); and
- bold language on the proxy card advises stockholders how uninstructed shares will be voted.

The final rules amend Rule 14a-8 to allow companies to exclude stockholder proposals regarding say-on-pay or say-on-frequency, but only if:

- in the most recent say-on-frequency vote, a single frequency option has obtained majority support (not just plurality support, as the SEC had proposed); and
- the company has adopted a say-on-frequency policy consistent with that majority choice.

A footnote in the rule release provides that, although the SEC has not promulgated voting standards generally in the new rules, for purposes of determining a “majority” vote to exclude say-on-frequency proposals under Rule 14a-8, abstentions will not count as votes cast.

The new rules introduce a new requirement to disclose the company’s frequency option decision. The SEC had initially proposed adding this disclosure requirement to Form 10-Q or Form 10-K. Instead, the SEC opted in the final rules to implement a new Form 8-K Item 5.07 requirement, Item 5.07(d). Form 8-K Item 5.07(b) already requires companies to disclose the results of stockholder votes. The Form 8-K filing to report the voting results must be made within four business days after the stockholder meeting ends. The new frequency option decision disclosure need not be included in the same Form 8-K, although many companies may choose to do so. The final rules instead permit companies to file an amendment to their Form 8-K to disclose the company’s frequency option decision. The amendment must be filed no later than 150 calendar days after the end of the stockholder meeting, but in no event later than 60 calendar days prior to the deadline for the submission of Rule 14a-8 stockholder proposals.

Missing the filing deadline for an Item 5.07 Form 8-K will cause companies to lose their eligibility to file Form S-3 registration statements (absent a subsequent waiver from the SEC Staff).

Additional Provisions of the Final Rules

The final rules provide that:

- no preliminary proxy filing is triggered by including say-on-pay or say-on-frequency votes in a proxy statement;
- proxy statements that include a say-on-pay or say-on-frequency vote must explain the general effect of the vote, such as whether the vote is non-binding;
- because companies with outstanding indebtedness under the Troubled Asset Relief Program (TARP) are already required to propose annual say-on-pay votes, they need not provide duplicative say-on-pay and say-on-frequency votes under the SEC's new rules. These companies must, however, propose say-on-pay and say-on-frequency votes at their first annual meeting after repaying TARP indebtedness;
- IPO companies have been given no exemption from the new rules;
- smaller reporting companies need not propose say-on-pay and say-on-frequency votes until stockholder meetings occurring on or after January 21, 2013; new CDIs 169.01-169.03 provide specific transition guidance for companies entering and exiting smaller reporting company status;
- the requirement that the say-on-pay vote cover CD&A does not require smaller reporting companies to begin including CD&A in their proxies; and
- although not required, the new rules do not prohibit companies from seeking additional specific stockholder feedback about discrete compensation issues, such as additional separate advisory votes to approve cash compensation or severance packages.

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