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SEC Proposes Rules for Say-on-Compensation Votes

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The SEC has proposed rules in connection with the three say-on-compensation advisory votes required by Section 951 of the Dodd-Frank Act. The three advisory votes are:

- **Say-on-Pay** — To approve the compensation of named executive officers ("NEOs"), as disclosed pursuant to the SEC's compensation disclosure rules
- **Say-on-Frequency** — To determine whether say-on-pay votes will occur every 1, 2 or 3 years
- **Say-on-Parachutes** — To approve agreements or understandings and compensation when shareholders are asked to approve certain business combination transactions

Highlights of the SEC's proposal are summarized below. The SEC has requested comments on its proposals by November 18, 2010.

General

- As proposed, each of the three votes would be non-binding. None of the votes would overrule any decision by a company or its board or create or imply any change or addition to fiduciary duties for the company or its directors. The votes also do not restrict or limit the ability of shareholders to make compensation-related proposals, but, as discussed below, following the wishes of the plurality of shareholders on the say-on-frequency vote will provide an opportunity to exclude certain shareholder proposals.
- The SEC is not prescribing the specific language or form of resolution that must be used for the three votes.
- As required by Section 957 of the Dodd-Frank Act, there will be <u>no</u> broker discretionary voting on any of the three votes.
- Smaller reporting companies will <u>not</u> be exempt from the new requirements.

Implementation/Timetable[1]

- Companies are required to present initial say-on-pay and say-on-frequency votes at their first annual meeting (or special meeting of shareholders for which the proxy solicitation rules require executive compensation disclosure[2]) occurring on or after January 21, 2011, regardless of whether the SEC has adopted final rules by that time.

- If the SEC's rules have not been finalized prior to the filing of a proxy statement relating to a meeting on or after January 21, 2011, the SEC has provided the following interim guidance:

  - The company is not required to file a preliminary proxy statement simply because say-on-pay and say-on-frequency votes are included.

  - The SEC staff will not object to the form of proxy relating to the say-on-frequency vote if it provides means for shareholders to specify among four choices: 1 year, 2 years, 3 years or abstain.

  - If the company's proxy service provider is unable to adjust its systems to be able to handle having these four choices on the proxy card, the company can include three choices (1 year, 2 years or 3 years) along with an instruction informing shareholders that if they do not mark anything on their proxy card, then their proxy will not be voted with respect to the say-on-frequency vote.

- Companies will not be required to present a say-on-parachute vote or the accompanying golden parachute arrangements disclosure until the effective date of the SEC's rules.

Say-on-Pay

- At least once every three years,[3] companies must give shareholders the opportunity to vote to approve the compensation of the company's NEOs as such compensation is disclosed in Item 402 of Regulation S-K, including CD&A,[4] the compensation tables and other narrative executive compensation disclosures required by Item 402.

- The say-on-pay vote does not encompass disclosures required by Item 402 about (1) the company's compensation policies and practices for employees generally as they relate to risk management and risk-taking incentives and (2) director compensation. The SEC notes, however, that to the extent risk considerations are a material aspect of a company's compensation policies or decisions for NEOs, the company is required to discuss that as part of its CD&A, and therefore such disclosure would be part of what shareholders are voting on.

- Although the SEC does not prescribe specific required wording for the say-on-pay vote, in the proposing release the SEC notes that the vote must be: "to approve the compensation of executives, as disclosed pursuant to Item 402 of Regulation S-K or any successor thereto." Proposals on different matters, such as a vote to approve a company's compensation policies and procedures, would not be sufficient.[5]

- The SEC would amend CD&A to require companies to address whether and, if so, how, compensation policies and decisions have taken into account the results of prior say-on-pay votes.[6] The SEC requests comment as to whether companies should discuss the impact of only the most recent vote or of all previous votes. In addition, the SEC requests comment as to whether this disclosure should always be required or only required to the extent that a company deems it to be material.

- The proxy rules will be amended so that including a say-on-pay vote in a proxy statement will not trigger a preliminary proxy filing.

Say-on-Frequency

- At least once every six years, shareholders must be given the opportunity to vote on whether the say-on-pay vote will occur every 1, 2 or 3 years.

- Although the SEC's proposal is based on its interpretation of the Dodd-Frank Act as providing that the say-on-frequency vote is not binding, in light of the Act's ambiguous statutory language, the SEC seeks comment on its plans to treat the vote as non-binding.

- As proposed, the say-on-frequency vote will result in shareholders, for the first time, being given a choice among four voting alternatives: 1 year, 2 years, 3 years and abstain. Rule 14a-4, which currently only contemplates "for," "against" and "abstain" votes on proposals (other than in director elections), will be amended to permit this. The proxy statement and proxy card will need to clearly explain that the proxy card has four choices and that the shareholders are not voting to approve or disapprove any company recommendation on frequency.[7]

- The SEC does not propose to prescribe plurality voting or any other specific voting standard for determining which frequency "wins" the non-binding vote. However, as explained below, the SEC does propose to establish a voting standard that will be used to determine whether a company can omit future Rule 14a-8 shareholder proposals relating to say-on-pay or say-on-frequency.

- A company will be allowed to exclude shareholder proposals that propose a vote on the approval of executive compensation as disclosed pursuant to Item 402 or on the frequency of such votes, so long as the company has adopted a policy on the frequency of say-on-pay votes that is consistent with the plurality of votes cast in the most recent say-on-frequency vote. The SEC requests comment as to whether the ability to exclude such proposals should still apply if the company has materially changed its compensation program in the period since the most recent say-on-pay vote or say-on-frequency vote.

- The company would be required to disclose, in its Form 10-Q covering the period during which a say-on-frequency vote occurs (or in its Form 10-K if the vote occurs during the fourth quarter), its decision regarding how frequently it will conduct say-on-pay votes in light of the results of the say-on-frequency vote. The company may also make this disclosure voluntarily in a Form 8-K when it reports the results of the voting (and the SEC seeks comments as to whether this should be the mandatory method of disclosure).[8]

- The SEC specifically asks for comment on whether an IPO company should be able to disclose the planned frequency of its say-on-pay votes in its Form S-1 and then be exempt from conducting say-on-pay and say-on-frequency votes until the year disclosed.

- The proxy rules will be amended so that including a say-on-frequency vote in a proxy statement will not trigger a preliminary proxy filing.

Say-on-Parachutes

The SEC's proposal regarding the say-on-parachute vote involves both a new disclosure requirement and the vote itself.

New Disclosure Requirement

- Section 951 requires "clear and simple" disclosure of any agreements or understandings concerning any type of compensation (whether present, deferred or contingent) that is based on or otherwise related to specified business combination transactions. To implement this requirement for expanded disclosure of golden parachute compensation arrangements, the SEC has proposed new Item 402(t) of Regulation S-K, as described below.

- The SEC proposal requires disclosure regarding golden parachute compensation arrangements for a wider swath of transactions than is mandated by Section 951. Section 951 requires expanded disclosure in proxy or consent solicitations materials whenever a company seeks shareholder approval of an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all of the company's assets. The SEC has proposed also to require expanded disclosure in connection with:

    - information statements filed under Regulation 14C;

    - proxy or consent solicitations that do not contain merger proposals but where other business is being acted on (such as authorization to issue stock in a merger) that triggers an obligation to provide the same disclosure that would be required if a merger proposal were being voted on;

- registration statements on Forms S-4 and F-4 containing disclosure relating to mergers and similar transactions;
- Rule 13e-3 going private transactions; and
- third-party tender offers and Schedule 14D-9 solicitation/recommendation statements.

– The SEC has further proposed to expand the scope of Section 951 to include disclosure of all arrangements among the target and acquiring company and the NEOs[9] of each. As a result, disclosure will be required about golden parachute agreements and understandings between the acquiring company and the NEOs of the target company, even if the acquiring company is not soliciting proxies.[10]

– While the disclosure requirements have been expanded both in terms of transactions covered and in terms of scope, the say-on-parachute vote requirement still only pertains to the disclosures required by Section 951.

– Proposed new S-K Item 402(t) will require disclosure of golden parachute compensation arrangements in the following tabular format:

Name (a)	Cash ($) (b)	Equity ($) (c)	Pension/ NQDC ($) (d)	Perquisites/ Benefits ($) (e)	Tax Reimbursement ($) (f)	Other ($) (g)	Total ($) (h)
PEO							
PFO							
A							
B							
C							

The “Cash” column includes any cash severance payments such as base salary, bonus and non-equity incentive plan payments. The “Equity” column includes the dollar value of accelerated stock awards, the spread on any accelerated options and any payments made in connection with the cancellation of awards. The “Other” column picks up any additional elements of compensation not otherwise specifically included in the table. The items included in each column must be separately identified and quantified in a footnote. Companies are also required to footnote which amounts are attributable to “single-trigger” arrangements and to “double-trigger” arrangements.

Any required calculations will be based on (1) the latest practicable date, when the table is provided in a proxy statement or consent solicitation relating to a covered transaction or (2) the last business day of the company's fiscal year, when the table is voluntarily provided in an annual meeting proxy statement, as described in more detail below.

- Item 402(t) also requires narrative disclosure of material facts necessary to understand each item included in the Golden Parachute Compensation table, including:
  - the specific circumstances that trigger payment;
  - payment mechanics, such as whether payment will be made in a lump sum or over time, and who will make the required payments; and
  - a description of any material conditions or obligations to receipt of payments (such as non-compete, non-solicitation, non-disparagement or confidentiality agreements).
- In light of the language of Section 951, the SEC's required disclosures under Item 402(t) will include the following items that are usually not reportable in the Summary Compensation Table or in the annual disclosure of potential payments upon termination or change-in-control required by Item 402(j):
  - group life, health, hospitalization or medical reimbursement plans or other benefit arrangements that do not discriminate in scope, terms or operation in favor of executive officers and that are available generally to all salaried employees; and
  - perquisites and other personal benefits below $10,000 in the aggregate.
- Item 402(t) does not require disclosure with respect to:
  - compensation disclosed in the Pension Benefits Table and Nonqualified Compensation Table (other than pension and nonqualified deferred compensation enhancements, which will be reported in the "Pension/NQDC" column of the Golden Parachute Compensation table);
  - previously vested equity awards; and
  - bona fide post-transaction employment agreements to be entered into with the acquirer in connection with the transaction (although information about such arrangements will still usually be disclosed under existing rules).
- The SEC proposal does not mandate Item 402(t) disclosure in annual meeting proxy statements. However, companies are permitted to provide the enhanced disclosure in their

annual meeting proxy statements in order to take advantage of the exception to the say-on-parachute vote requirement contained in Section 951 (described below) that applies to agreements and understandings that have already been subject to a say-on-pay vote.[11]

- Item 402(t) will not apply to agreements and understandings with senior management of foreign private companies.

Say-on-Parachute Vote

- Companies will be required to provide a separate shareholder advisory vote on golden parachute compensation arrangements required to be disclosed under Item 402(t) in proxy statements for meetings at which shareholders are asked to approve an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all of the company's assets. As noted above, while the disclosure requirements have been expanded both in terms of transactions covered and in terms of scope, the say-on-parachute vote requirement still only pertains to the disclosures required by Section 951.

- Companies will not be required to conduct a separate say-on-parachute vote with respect to compensation that has previously been disclosed under Item 402(t) and subject to a say-on-pay vote, even if the shareholders voted not to approve such compensation. This exception is only available to the extent the arrangements that were previously the subject of a say-on-pay vote remain in effect and have not been modified. New arrangements, and any revisions to previously voted-on arrangements, would be subjected to a separate say-on-parachute vote in connection with approval of the transaction.[12] As proposed, a new say-on-parachute vote would generally not be required solely because fluctuations in the company's stock price change the payout amount. However, if the change resulted in a tax gross-up becoming payable, a new vote appears to be required. The SEC seeks comment on what changes from prior Item 402(t) disclosure provided as part of a say-on-pay vote should trigger the need for a new say-on-parachute vote.

- The say-on-parachute vote covers all compensation disclosed pursuant to Item 402(t), other than (1) compensation previously subject to a say-on-pay vote (as described in the prior bullet) and (2) any agreements or understandings between an acquiring company and the NEOs of the target where only the target is soliciting votes from its shareholders (as described above in the third bullet under "Disclosure").

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[1] TARP recipients that have not repaid their outstanding indebtedness under TARP are already required under the Emergency Economic Stabilization Act of 2008 to have an annual vote to approve executive compensation. The SEC has proposed that such TARP recipients will not be required to conduct say-on-pay or say-on-frequency votes under the new rules until they have repaid all indebtedness under TARP.

[2] It is uncertain whether a company would be required to include the votes at a special meeting where directors are not being elected, but Item 402 disclosure is required because a compensation

plan is being acted on. Footnotes to the SEC proposing release indicate that the vote is only intended to be required at special meetings in connection with the election of directors, but the proposed text of the new rule itself refers more broadly to special meetings for which SEC rules require executive compensation disclosure (which includes special meetings called to act on compensation plans).

[3] The SEC's proposed language to implement this 3-year requirement (and the corresponding 6-year requirement with respect to the say-on-frequency vote) may raise unexpected timing issues for companies that change the date of their annual meetings during the applicable periods. For example, the proposed say-on-pay vote rule specifies that a vote is required "for the first annual or other meeting of shareholders on or after January 21, 2011 and not less frequently then once every 3 years thereafter." This language appears to tie the 3-year deadline to the date of the prior meeting.

[4] Shareholders of smaller reporting companies who, under current rules do not have to include CD&A, would not be required to include CD&A as a result of the new rules.

[5] The rules, however, do not prohibit a company from seeking more specific shareholder opinion through additional separate votes on cash compensation, golden parachute policy, severance or other aspects of compensation.

[6] This proposed disclosure is not mandated by Section 951, but the SEC believes that the information would facilitate better investor understanding of companies' compensation decisions.

Smaller reporting companies would not have to make this disclosure, except to the extent it was a material factor that must be addressed under Item 402(o) of Regulation S-K, which requires smaller reporting companies to provide a narrative description of any material factors necessary to an understanding of the information in the summary compensation table.

[7] It is expected that Boards will include a voting recommendation as to the say-on-frequency vote in the proxy statement.

[8] The rule proposal does not address what happens if the company later changes its decision.

[9] The proposed instructions to Item 402(t) would provide that companies would not need to provide Item 402(t) disclosure with respect to persons who are considered to be NEOs because they are individuals who would have been among the three most highly compensated executive officers but for the fact that they were not serving as executive officers at the end of the last completed fiscal year.

[10] As discussed below, this disclosure requirement does not include bona fide post-transaction employment agreements.

[11] Including Item 402(t) disclosure in an annual meeting proxy statement will satisfy the existing disclosure requirement in Item 402(j) with respect to potential payments to NEOs upon a change in control of the issuer. However, the company must still provide the disclosure required by Item 402(j) with respect to potential payments to NEOs upon termination of employment other than in a change in control context.

[12] The required say-on-parachute vote would only be with respect to the new arrangement and revised terms. To accomplish this, companies would need to provide two separate tables under Item 402(t) — one disclosing all arrangements and the other only describing the new arrangements or revised terms.

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