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Securities Alert

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SEC Proposes Say-on-Pay Rules

Advisory Votes on Executive Compensation and "Golden Parachute" Compensation, and Frequency of the Executive Compensation Vote

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The Securities and Exchange Commission (SEC) has proposed rules regarding shareholder advisory votes on executive compensation and "golden parachute" compensation arrangements,[1] implementing certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The SEC has also proposed rules on reporting of proxy votes on executive compensation by institutional investment managers.[2] New Section 14A of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), added by Section 951 of the Dodd-Frank Act, requires public companies to conduct a non-binding shareholder advisory vote to approve the compensation of a company's named executive officers disclosed pursuant to Item 402 of Regulation S-K under the Securities Act of 1933, as amended (a so-called "say-on-pay" vote), and a separate, non-binding shareholder advisory vote to determine how often a company will conduct the shareholder vote on executive compensation (a so-called "say-on-frequency" vote). These votes are required to be included in a proxy statement for which the proxy solicitation rules of the SEC require compensation disclosures,[3] for a company's first annual or other meeting of shareholders taking place on or after January 21, 2011, regardless of whether or not the SEC's rules on say-on-pay and say-on-frequency have been finalized by that date.

Section 14A also requires public companies to provide disclosure regarding certain so-called "golden parachute" compensation arrangements, as described in further detail below, when engaged in mergers or similar transactions and, in most circumstances, to conduct a separate, non-binding shareholder advisory vote to approve the golden parachute compensation arrangements. In addition, Section 14A requires institutional investment managers to report annually how they voted on executive compensation proposals in each company's proxy statement in which they have been delegated direct or indirect voting power by their clients. Unlike the say-on-pay and say-on-frequency votes that are automatically effective on January 21, 2011 under the Dodd-Frank Act, companies will not be required to solicit shareholder votes on golden parachute compensation arrangements until the SEC adopts final rules and such rules become effective.

The SEC has not, under its proposed rules, exempted smaller reporting companies from any of the say-on-pay rules or other disclosure requirements discussed below. Therefore, commencing January 21, 2011, smaller reporting companies will also have to comply with the say-on-pay and the say-on-frequency vote requirements. The SEC was directed by the Dodd-Frank Act to consider whether smaller reporting companies should be exempt from these rules, and in the proposing release on these rules, the SEC asks for public comment as to whether such an exemption would be appropriate. However, unless the SEC changes its position in the adopting release, smaller reporting companies will be subject to the same requirements as other public companies.

Say-on-Pay Vote

Proposed Rule 14a-21(a) under the Exchange Act will require a public company to include in its proxy statement, in which disclosure of executive compensation under Item 402 of Regulation S-K is included, for an annual or other meeting of shareholders, a shareholder advisory vote to approve the compensation of its named executive officers, at least once every three years. This "say-on-pay" shareholder advisory vote would not be binding on a company or its board of directors. The SEC did not prescribe specific language or a particular form of resolution to be used for this vote.

The compensation of named executive officers to be voted on by the shareholders is the compensation companies are required to disclose pursuant to Item 402 of Regulation S-K, which is comprised of the Compensation Discussion and Analysis (CD&A) section, compensation tables, and other narrative executive compensation disclosures. Director compensation reported under Items 402(k) and 402(r) of Regulation S-K would not be subject to the shareholder advisory vote. In addition, disclosure pursuant to Item 402(s) about a company's compensation policies and practices as they relate to risk management and risk-taking incentives would not be subject to the shareholder advisory vote because such disclosure relates to compensation of all employees, not just named executive officers. However, to the extent a company's CD&A addresses such risk-related policies and practices, shareholders could consider such matters in casting their say-on-pay votes.

For smaller reporting companies, the say-on-pay advisory vote to approve executive compensation will not change the scaled compensation disclosure under Section 402 of Regulation S-K, and smaller reporting companies will not be required to provide in connection with the vote a CD&A nor any of the other disclosures not required presently under Item 402.

Amendment to Schedule 14A—New Item 24A

Proposed new Item 24A of Schedule 14A would require a company to disclose that a say-on-pay and/or say-on-frequency vote is being taken by the shareholders and to describe the general effect of such votes, including disclosure of the non-binding nature of the votes. Companies would not be required to state in advance what action they plan to take in response to a say-on-pay vote.

Say-on-Frequency Vote

Proposed Rule 14a-21(b) under the Exchange Act will require a company to include in its proxy statement for an annual or other meeting of shareholders, in which executive compensation disclosure is required, a separate shareholder advisory vote to approve the ***frequency*** of the say-on-pay vote described above. This vote as to the frequency of the say-on-pay vote must be conducted at least once every six years. The "say-on-frequency" shareholder advisory vote would determine whether the say-on-pay vote will be taken every year, every other year, or every three years, and would also not be binding on a company or its board of directors.

Under this proposed rule, a company would be required to include the following four choices on its proxy card for the say-on-frequency vote: "one year," "two years," "three years," and "abstain." The choice that receives a plurality of votes will constitute the prevailing choice. The SEC expects a company's board of directors to include a recommendation to shareholders as to its views on how frequently the vote should occur, but the proxy materials must make it clear that the shareholders are voting on the four choices described above and not on the approval or disapproval of the board's recommendation. Brokers, transfer agents, and data processing firms will be required to make technical changes to their tabulation systems to accommodate the choice among these four options. It is as yet unclear whether these agents will be able to adapt their systems to accommodate these changes in time to have them in place for meetings that are scheduled to occur on or shortly after January 21, 2011.

Amendment to Rule 14a-6—No Preliminary Proxy Statement Filing Required for Say-on-Pay Votes

The proposed amendment to Rule 14a-6 under the Exchange Act would add say-on-pay and say-on-frequency votes required by Section 14A(a) of the Exchange Act to the list of items that do not trigger the filing of a preliminary proxy statement.

Amendment to CD&A Disclosure

The proposed rules would amend Item 402(b) of Regulation S-K to require a company to address in its CD&A whether, and if so, how, its compensation policies and decisions have been revised to take into account the results of previous say-on-pay votes. This disclosure would be a mandatory topic to be covered in the CD&A. A company which first includes a say-on-pay vote in its proxy statement for the 2011 annual meeting of shareholders would be required to include this new CD&A disclosure in its proxy statement for the 2012 annual meeting of shareholders.

Smaller reporting companies, which are not required to include a CD&A in their proxy statements, will not be subject to this additional disclosure requirement under Item 402(b).

Amendments to Form 10-K and Form 10-Q

Proposed amendments to Item 9B of Form 10-K and new Item 5(c) of Part II of Form 10-Q would require a company to disclose, in the quarterly report on Form 10-Q covering the period during which the shareholder advisory vote on say-on-frequency occurs, or in the annual report on Form 10-K if the say-on-frequency vote occurs during the company's fourth quarter, whether and how it plans to implement the result of the most recent say-on-frequency vote. In particular, a company would be required to disclose the frequency with which it plans to conduct say-on-pay votes in light of the results of the say-on-frequency vote. The proposed amendments to Form 10-K and Form 10-Q seek to provide timely notice to the shareholders as to whether a company plans to follow the recommendation reflected in the results of the most recent say-on-frequency vote.

Amendment to Rule 14a-8—Exclusion of Particular Shareholder Proposals

The proposed amendment to Rule 14a-8 under the Exchange Act would add a note to Rule 14a-8(i)(10) clarifying that a company would be permitted to exclude a shareholder proposal that seeks an advisory vote on executive compensation or relates to the frequency of shareholder votes on executive compensation from its proxy statement as having been already "substantially implemented" if the company has adopted a policy on the frequency of say-on-pay votes that is consistent with the plurality of the votes cast in the most recent say-on-frequency vote. A description of a company's proposed implementation of the results of the say-on-frequency vote would be required in the Form 10-Q or Form 10-K for the period in which the vote occurred, as described above.

Say-on-Golden-Parachutes

Vote Requirement

Proposed Rule 14a-21(c) under the Exchange Act would require a company to include in its proxy statement for a meeting at which shareholders are asked to approve an acquisition, merger, consolidation, or proposed sale of all or substantially all assets of the company, a separate shareholder advisory vote to approve any golden parachute compensation arrangements that are disclosed pursuant to proposed Item 402(t) of Regulation S-K between the soliciting company and its named executive officers or the named executive officers of the acquiring company, if the soliciting company is not the acquiring company. Compensation arrangements between the acquiring company and the named executive officers of the target company would require disclosure under proposed Item 402(t), but will not be subject to the shareholder advisory vote. This "say-on-golden-parachutes" shareholder advisory vote would also not be binding on a company or its board of directors. The SEC did not prescribe specific language or a particular form of resolution to be used for this vote.

In accordance with Section 14A(b)(2) of the Exchange Act, a company would not be required to include in its proxy statement for a merger or similar transaction a separate shareholder vote on golden parachute compensation if disclosure of the same golden parachute arrangements pursuant to Item 402(t) had been included in the executive compensation disclosure that was subject to a prior vote of shareholders under Section 14A(a)(1) of the Exchange Act and Rule 14a-21(a). If the golden parachute arrangements subject to a prior shareholder vote have been modified since they were subject to a shareholder vote, only the new arrangements and revised terms of the arrangements would be subject to a separate shareholder vote in the proxy statement for a merger or similar transaction under Section 14A(b)(2) of the Exchange Act and Rule 14a-21(c). A grant of new equity compensation awards would be considered a modification of the golden parachute compensation under the proposed rules.

When a company provides for a vote on revisions to or additional golden parachute compensation arrangements, the company would be required to include two tables in its merger proxy statement under Item 402(t): one table for all golden parachute compensation that had previously been disclosed in the prior say-on-pay vote plus all new or revised arrangements, and a second table solely for the new and revised arrangements that are subject to the vote in the merger proxy statement.

Disclosure—Item 402(t) of Regulation S-K

In accordance with new Section 14A(b)(1) of the Exchange Act, the SEC has proposed to amend Schedule 14A to require additional, clear disclosure regarding "golden parachute" compensation arrangements. This requirement, under proposed Item 402(t) of Regulation S-K, would apply to proxy or consent solicitations seeking shareholder approval of an acquisition, merger, consolidation, or proposed sale or disposition of all or substantially all of a company's assets, as well as to other disclosure forms used in mergers or similar transactions, such as Form S-4 and Schedule TO. "Golden parachute" compensation is compensation that would become payable to a named executive officer that is based on, or otherwise related to, a merger or similar transaction, including severance payments, payments for the acceleration of options or other equity compensation grants, perquisites, and any other elements of compensation as described further below.

Item 402(t) would require, in both tabular and narrative formats, disclosure of agreements or understandings with respect to golden parachute executive compensation arrangements between each named executive officer of the target company, on the one hand, and either the acquiring company or the target company, on the other hand, related to the transaction. Item 402(t) would require that the following table be included in the disclosure document relating to the transaction:

Golden Parachute Compensation

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

* Non-qualified deferred compensation

The table would present quantitative disclosure of the individual elements of compensation that an executive would receive that are based on or otherwise relate to the merger or similar transaction, and the total amount payable to each named executive officer. The following elements would be separately quantified and included in the total:

- any cash severance payment, such as base salary, bonus, and non-equity incentive plan compensation payments (column (b));
- 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 (column (c));
- pension and nonqualified deferred compensation benefit enhancements (column (d));
- perquisites and other personal benefits and health and welfare benefits, without a de minimis exclusion (column (e));
- tax reimbursements, such as Internal Revenue Code Section 280G tax gross-ups (column (f)); and
- any additional, "other" elements of compensation not specifically includable in the other columns of the table (column (g)).

As proposed, the table would require footnote identification of each separate form of compensation reported and amounts attributable to "single-trigger" arrangements (triggered upon consummation of the transaction) and to "double-trigger" arrangements (triggered only after the occurrence of a termination following the consummation of the transaction). The quantification would apply only to incremental amounts of compensation related to the merger or similar transaction, and therefore, the table would not include vested equity awards and amounts set forth in the Pension Benefits and Nonqualified Deferred Compensation tables. In addition, bona fide employment agreements to be entered into in connection with the merger or similar transaction and effective on or after the date the transaction is consummated would not be required to be disclosed or quantified under Item 402(t). Disclosure of an estimated range of payments would not be permitted.

Narrative disclosure following the table would be required to describe the specific circumstances triggering each payment, who would make the payment, whether the payment will be made in installments, material conditions or obligations applicable to each payment, duration of such conditions or obligations, and provisions related to waiver or breach of such conditions or obligations.

In a proxy statement soliciting shareholder approval of a merger or similar transaction, the tabular quantification of dollar amounts based on a company's stock price required by Item 402(t) would be based on the closing price per share as of the latest practicable date. Where Item 402(t) disclosure is included in an annual meeting proxy statement, such amounts would be calculated based on the closing market price per share of the company's securities on the last business day of its last completed fiscal year.

Companies would not be required to provide disclosures under Item 402(t) in annual meeting proxy statements, but would be allowed to do so. This additional disclosure would also be required of smaller reporting companies in connection with any vote to approve any golden parachute compensation arrangements whether they be contained in annual meeting or merger proxy statements. However, the SEC has proposed an exception to the disclosure obligations under Item 402(t) with respect to agreements and understandings with senior management of foreign private issuers where the target or acquirer is a foreign private issuer.

Timing and Transition

Companies are required to include a say-on-pay shareholder advisory vote and a say-on-frequency shareholder advisory vote in both their preliminary and definitive proxy statements for their first annual or other meetings of shareholders taking place on or after January 21, 2011 (six months following the enactment of the Dodd-Frank Act), regardless of whether the SEC has adopted final rules to implement Section 14A of the Exchange Act by that date. Because proxy statements for shareholder meetings to be held in January 2011 are likely to be filed in November or December 2010, a number of companies will be including shareholder advisory votes in their proxy statements prior to the effectiveness of the final SEC rules. Therefore, companies should promptly begin to consider revisions to their proxy statement disclosure in connection with the newly required votes.

Unlike the inclusion of say-on-pay and say-on-frequency votes, the shareholder advisory vote to approve golden parachute compensation arrangements and related disclosure regarding golden parachute compensation arrangements under proposed Item 402(t) of Regulation S-K is not required to be included in merger proxy statements and other applicable SEC filings until the effective date of the SEC's final rules.

Because the say-on-pay and say-on-frequency votes will be required to be implemented prior to the adoption of the final rules, the SEC has stated the following:

- it will not object if companies do not file preliminary proxy statements with respect to say-on-pay votes and say-on-frequency votes;
- while proxy service providers are reprogramming their systems to permit shareholders to select among the four choices on the proxy card for the say-on-frequency votes, it will not object if shareholders are only offered the choice of holding the say-on-pay vote every year, every two years, or every three years, and if no choice is selected by a shareholder, the proxy will not be voted; and
- companies that are required to hold an annual say-on-pay vote because they have received financial assistance under the Troubled Asset Relief Program (TARP) would not be required to include say-on-pay and say-on-frequency votes in their proxy statements until they have repaid all of their TARP indebtedness and are no longer subject to the annual say-on-pay vote requirement under TARP.

Broker Discretionary Voting

As prescribed by Section 957 of the Dodd-Frank Act, in September 2010 the SEC approved rules prohibiting brokers who hold securities on behalf of their clients to vote shares for which they have not received instructions from their clients on say-on-pay proposals and say-on-frequency proposals.

Reporting of Executive Compensation Votes by Institutional Investment Managers

Proposed Rule 14Ad-1 under the Exchange Act would require institutional investment managers subject to Section 13(f) of the Exchange Act, which are generally institutional investment managers that manage certain equity securities having an aggregate fair market value of at least $100 million, to report annually how they voted on executive compensation proposals in each company's proxy statement in which they have been delegated direct or indirect voting power by their clients. The votes would be required to be reported annually on Form N-PX not later than August 31st of each year, for the most recent 12-month period ended June 30th. As proposed, the amended Form N-PX includes a cover page, a summary page and required proxy voting information. The information to be disclosed for each proxy vote taken at a meeting held on or after January 21, 2011 required to be included in a Form N-PX report includes, among other things, (1) identifying information about the issuer and the security; (2) a brief identification of the matter voted on; (3) the number of shares the manager was entitled to vote or had or shared voting power over; (4) the number of shares that were voted; (5) how the manager voted those shares; and (6) whether the vote was for or against management's recommendation.

What Steps Should Companies Take Now?

In light of the advent of the say-on-pay regime, companies should consider taking the following steps in order to ease the transition to the new rules.

1. Evaluate pay packages and practices to determine areas of potential vulnerability. The Council of Institutional Investors and Institutional Shareholder Services (ISS)/RiskMetrics have each prepared lists of "red flags" to watch for when voting on compensation, including single-trigger severance arrangements, tax gross-ups, absence of stock ownership guidelines, and absence of clawback policies. Companies should consider whether any executive compensation arrangements that

may cause controversy are justified in light of the potential for negative scrutiny.

2. Decide how frequently to recommend shareholders vote on compensation. We understand that many institutional shareholders are likely to vote against members of a board of directors if they recommend a say-on-pay vote any less frequently than once per year. ISS recommends that say-on-pay votes be held annually. This position should be taken into account in deciding what to recommend to shareholders in this year's proxy statement.

3. Consider whether to engage in outreach to shareholders to ascertain investor sentiment regarding pay packages in advance of the say-on-pay vote. Some companies have begun to engage in proactive outreach to shareholders in order to determine their level of satisfaction or dissatisfaction with executive compensation practices, in order to avoid surprises in the context of the say-on-pay vote. If your company does not employ controversial pay packages or has performed well during the past year, this kind of outreach may be unnecessary. Of course, any outreach to investors would need to be done in compliance with Regulation FD.

4. Revisit Compensation Discussion & Analysis disclosure to ensure that it tells a robust, clear, and compelling story about the rationale for the executive compensation packages in place at your company. Now more than ever, the CD&A will serve, in addition to a required element of compensation-related disclosure, as an advocacy piece to support the compensation to be voted upon by shareholders. The document should be reviewed to ensure that it is clear, concise, and supportive of the compensation practices of the organization.

5. Consider hiring a proxy solicitor to help increase the chances of a favorable vote on say-on-pay. As noted above, brokers will be unable to vote shares held by their customers with regard to any say-on-pay votes if they do not receive instructions from customers as to how they wish their shares to be voted. In light of this fact and the general likelihood that many investors may need additional advocacy in order to vote in favor of executive compensation practices, it may be helpful to retain a proxy soliciting firm in order to maximize your chances of a favorable result.

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We will continue to update you as we are apprised of further developments with respect to these new rule proposals. In the meantime, please contact the Mintz Levin attorney who advises you regarding securities compliance matters if you have any questions regarding these rule proposals or related matters.

Endnotes

1 See Release No. 34-63123 available on the SEC's website at http://sec.gov/rules/proposed/2010/34-63123.pdf.

2 See Release No. 33-9153 available on the SEC's website at http://sec.gov/rules/proposed/2010/33-9153.pdf.

3 Typically, these are proxy statements in which action to be taken includes the election of directors.

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