



## SEC Adopts Say-on-Pay Rules

On January 25, 2011, the Securities and Exchange Commission (the “SEC”) adopted rule changes to implement the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) relating to shareholder approval of executive compensation and “golden parachute” compensation arrangements.<sup>1</sup>

### Background

Section 951 of the Dodd-Frank Act requires that companies include a resolution in their proxy statements asking shareholders to approve, in a nonbinding vote, the compensation of their executive officers, as disclosed under Item 402 of Regulation S-K (the “Say-on-Pay” vote). A separate resolution is also required to determine whether this Say-on-Pay vote takes place every one, two, or three years (the “Say-on-Frequency” vote). If any golden parachute compensation has not been approved as part of a Say-on-Pay vote, the Dodd-Frank Act requires that companies solicit shareholder approval of golden parachute compensation through a separate nonbinding vote at the meeting where the shareholders are asked to approve a merger or similar extraordinary transaction that would trigger “golden parachute” payments (the “Say-on-Golden Parachute” vote). The Dodd-Frank Act requires that any proxy statement used for soliciting the Say-on-Golden Parachute vote must include clear and simple disclosure of the golden parachute arrangements or understandings and the amounts payable.

### Timing and Transition

Issuers must hold the Say-on-Pay and the Say-on-Frequency votes at the first annual shareholders’ meeting<sup>2</sup> occurring on or after January 21, 2011. The effective date of the new rule and rule amendments implementing Section 14A will be 60 days following the date of publication in the Federal Register, except that the rules governing the Say-on-Golden Parachute vote requirements and related disclosure will become effective for proxy statements and other filings that must include the golden parachutes disclosure on or after April 25, 2011.

Smaller reporting companies<sup>3</sup> will not be subject to the Say-on-Pay or Say-on-Frequency requirements and the SEC’s new rules until after the first annual meeting or other meeting of shareholders at which directors will be

<sup>1</sup> Release No. 33-9178 (January 25, 2011) (the “Adopting Release”). Section 951 of the Dodd-Frank Act added Section 14A to the Securities Exchange Act of 1934, as amended (the “Exchange Act”).

<sup>2</sup> The SEC states in footnote 18 of the Adopting Release that it views Section 951 of the Dodd-Frank Act as requiring a separate shareholder vote on executive compensation only with respect to “an annual meeting of shareholders for which proxies will be solicited for the election of directors, or a special meeting in lieu of such annual meeting.” Accordingly, Rules 14a-21(a) and 14a-21(b) are intended to apply in connection with the election of directors when the related proxy materials must include executive compensation disclosure.

<sup>3</sup> A “smaller reporting company” is generally defined for the purposes of its initial testing as an issuer that has a public float of less than \$75 million or, in the case of an issuer that has no public float, has annual revenues of less than \$50 million. A reporting issuer with a public float determines eligibility as a smaller reporting company as of the last business day of its most recently completed second fiscal quarter, calculating its float by multiplying (i) the aggregate worldwide number of shares of its (voting and non-voting) common equity held by non-affiliates by (ii) the price at which the common equity was last sold, or the average of the bid and asked prices, in the principal market. For any

elected, and for which executive compensation disclosure is required occurring on or after January 21, 2013. This temporary exemption does not apply to the Say-on-Golden Parachute vote requirement, to the extent that such requirement is applicable to a smaller reporting company.

- In light of the fact that the new rules and rule changes implementing Exchange Act Section 14A will become effective after most calendar year-end companies file preliminary or definitive proxy statements for 2011 annual meetings, the SEC has provided transition guidance that will facilitate compliance with Exchange Act Section 14A(a). Under this guidance: until the amendments to Rule 14a-6 discussed below become effective, the SEC will not object if an issuer does not file a preliminary proxy statement when the only matter that would trigger such a preliminary proxy statement filing is a Say-on-Pay or Say-on-Frequency vote.
- Until the amendments to Rule 14a-4 discussed below become effective, the SEC will not object if the form of proxy used by an issuer for a shareholder vote on a Say-on-Frequency resolution provides a means whereby persons solicited are afforded an opportunity to specify by boxes a choice among one, two, or three years, or abstain. Further, if proxy service providers are unable to accommodate these four choices for meetings to be held on or before December 31, 2011, the SEC will not object if the form of proxy for the Say-on-Frequency vote provides a means whereby the solicited persons are afforded the opportunity to specify by boxes a choice among one, two, or three years, and proxies are not voted on the Say-on-Frequency matter in the discretion of the proxy holder if a solicited person does not select one of those three choices.

With regard to the temporary exemption from the Say-on-Pay and Say-on-Frequency vote requirements for smaller reporting companies, the SEC notes in the adopting release that until the implementing rules are effective, the SEC will not object if a smaller reporting company does not include a resolution for a Say-on-Pay or Say-on-Frequency vote in its proxy statement for an annual meeting.

## THE SAY-ON-PAY VOTE

The SEC adopted new Rule 14a-21(a), which provides that if a solicitation is made by an issuer relating to an annual or other meeting of shareholders at which directors will be elected (and for which the SEC's rules require executive compensation disclosure pursuant to Item 402 of Regulation S-K), then the issuer must include a resolution for a Say-on-Pay vote for its first annual or other meeting of shareholders occurring on or after January 21, 2011, and that such Say-on-Pay vote must occur thereafter no later than the annual or other meeting of shareholders held in the third calendar year after the immediately preceding Say-on-Pay vote.

### What Is Covered by the Resolution?

Pursuant to Rule 14a-21(a), the Say-on-Pay vote relates to the executive compensation disclosure required to be included in the proxy statement, which generally includes the Compensation Discussion and Analysis (the "CD&A"), the compensation tables, and the narrative disclosure on executive compensation.<sup>4</sup>

### What Is Not Covered by the Resolution?

Instruction 2 to Rule 14a-21 provides that the two areas that are not covered by the Say-on-Pay vote are director compensation as required to be disclosed by Item 402(k) and Item 402(r) of Regulation S-K, and any disclosure pursuant to Item 402(s) of Regulation S-K about the issuer's compensation policies and practices as they relate to

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issuer that is above the smaller reporting company threshold at the time of its initial testing, when that issuer subsequently tests annually for smaller reporting company status, the applicable thresholds are: (i) less than \$50 million public float or, in the case of an issuer that has no public float, (ii) annual consolidated revenues of less than \$40 million during its previous fiscal year. See Exchange Act Rule 12b-2.

<sup>4</sup> The SEC notes in the Adopting Release that a vote to approve a proposal on a different subject matter, such as a vote to approve only compensation policies and procedures, would not satisfy the requirements of Exchange Act Section 14A and Rule 14a-21(a).

risk management and risk-taking incentives. However, if risk considerations are a material aspect of the issuer's compensation policies or decisions for named executive officers, then the Instruction indicates that the issuer is required to discuss these considerations as part of the CD&A, and such disclosure is therefore subject to the Say-on-Pay vote.

### What Must the Resolution Say?

Rule 14a-21(a) does not require that issuers use a specific form of resolution. However, Instruction to Rule 14a-21(a) provides the following nonexclusive example that would satisfy the requirements of the Rule: "RESOLVED, that the compensation paid to the company's named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including Compensation Discussion and Analysis, compensation tables and narrative discussion, is hereby APPROVED." While the SEC has provided this nonexclusive example, the SEC states in the Adopting Release that issuers "should retain the flexibility to craft the resolution language," so that we are likely to continue to see a variety of approaches in presenting the Say-on-Pay vote to shareholders.

### What Other Requirements Apply?

The SEC adopted the following additional requirements related to the mandated Say-on-Pay votes:

- *Additional Disclosure Item in the Proxy Statement:* New Item 24 to Schedule 14A requires disclosure, in the proxy statement in which the issuer is providing a Say-on-Pay vote, that explains the general effect of such vote, such as that the vote is nonbinding.
- *Additional CD&A Disclosure:* Amended Item 402(b)(1) of Regulation S-K requires an issuer to address in the CD&A whether, and if so, how, the issuer has considered the results of the most recent shareholder advisory vote on executive compensation (as required by Exchange Act Section 14A or the SEC's Rule 14a-20, which is the rule governing Say-on-Pay votes required for recipients of financial assistance under the Troubled Asset Relief Program, or "TARP") in determining compensation policies and decisions and, if so, how that consideration has affected the issuer's compensation decisions and policies. This requirement is included among the "mandatory" CD&A disclosure items specified by Item 402(b)(1) of Regulation S-K.

## SAY-ON-FREQUENCY VOTE

The SEC adopted new Rule 14a-21(b), which provides that if a solicitation is made by an issuer relating to an annual or other meeting of shareholders at which directors will be elected (and for which the SEC's rules require executive compensation disclosure pursuant to Item 402 of Regulation S-K), then the issuer must include a resolution for a Say-on-Frequency vote for its first annual or other meeting of shareholders occurring on or after January 21, 2011, and that such Say-on-Frequency vote must occur thereafter no later than the annual or other meeting of shareholders held in the sixth calendar year after the immediately preceding Say-on-Frequency vote.

### What Are the Choices for the Say-on-Frequency Vote?

Under Rule 14a-21(b), the required Say-on-Frequency resolution would ask whether shareholders want a Say-on-Pay vote to occur every one, two or three years. As a result, shareholders would be given four choices on the proxy card: whether the Say-on-Pay vote will take place every one, two, or three years, or to abstain from voting. In order to implement the voting choices for the Say-on-Frequency vote, the SEC amended Rule 14a-4 to specifically allow proxy cards to reflect the choices of one, two, or three years, or abstain.

### What Must the Resolution Say?

Rule 14a-21(b) does not require that issuers use a specific form of resolution. Unlike with respect to the Say-on-Pay vote requirements in 14a-21(a), the SEC does not provide a nonexclusive example of a Say-on-Frequency resolution. Neither Rule 14a-21(b) nor the SEC's other proxy rules require that the issuer make a recommendation with respect to the Say-on-Frequency vote; however, the SEC notes that proxy holders may vote uninstructed proxy cards in accordance with management's recommendation only if the issuer follows the existing requirements of Rule 14a-4, which include specifying how proxies will be voted (i.e., in accordance with management's recommendations) in the absence of instruction from the shareholder.

### What Other Requirements Apply?

The SEC adopted the following additional requirements related to the mandated Say-on-Frequency votes:

- *Additional Disclosure Item in the Proxy Statement:* New Item 24 to Schedule 14A requires disclosure, in the proxy statement in which the issuer is providing a Say-on-Pay Frequency Vote, that explains the general effect of such vote, such as that the vote is nonbinding. Issuers also must disclose, when applicable, the current frequency of Say-on-Pay votes and when the next scheduled Say-on-Pay vote will occur.
- *New Form 8-K amendment:* An amendment to Item 5.07 of Form 8-K requires that an issuer must disclose its decision as to how frequently the issuer will conduct Say-on-Pay votes following each Say-on-Frequency vote. In order to comply with this requirement, an issuer must file an amendment to its prior Form 8-K filing (or filings) that disclosed the preliminary and final results of the Say-on-Frequency vote. The Form 8-K amendment will be due no later than 150 calendar days after the date of the end of the annual meeting in which the Say-on-Frequency vote occurred, but in no event later than 60 calendar days prior to the deadline for the submission of shareholder proposals as disclosed in the proxy materials for the meeting at which the Say-on-Frequency vote occurred. Specifically with respect to Say-on-Frequency votes, an issuer must disclose the number of votes cast for each of the choices, as well as the number of abstentions in Item 5.07 of Form 8-K.
- *Exclusion of Shareholder Proposals:* The SEC added a new Note to Rule 14a-8(i)(10)<sup>5</sup> to permit the exclusion of a shareholder proposal that would provide a Say-on-Pay vote, seek future Say-on-Pay votes, or relate to the frequency of Say-on-Pay votes in certain circumstances. Such shareholder proposals could be excluded under the new Note if, in the most Say-on-Frequency vote, a single frequency received a majority of votes cast and the issuer adopted a policy for the frequency of Say-on-Pay votes that is consistent with that choice.<sup>6</sup> For the purposes of this Note, the SEC notes in footnote 151 of the Adopting Release that that an abstention would not count as a vote cast.

### SAY-ON-GOLDEN PARACHUTE VOTE

The SEC adopted Rule 14a-21(c), which provides that if a solicitation is made by the issuer for a meeting of shareholders at which the shareholders are asked to approve an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all assets of the issuer, then the issuer must provide a separate shareholder vote to approve any agreements or understandings and compensation disclosed pursuant to Item 402(t) of Regulation S-K. However, if such agreements or understandings have been subject to a shareholder advisory vote under Rule 14a-21(a) (the Say-on Pay vote), then a separate shareholder vote is not required.

<sup>5</sup> Exchange Act Rule 14a-8(i)(10) permits the exclusion of a shareholder proposal when the issuer has "substantially implemented" the proposal.

<sup>6</sup> In changing from a plurality voting standard as proposed to a majority voting standard, the SEC stated that it recognized that it may be possible that no single choice will receive a majority of votes and, as a result, there may be situations where issuers will not be able to rely on the Note to Rule 14a-8(i)(10) to exclude subsequent shareholder proposals on Say-on-Pay or Say-on-Frequency matters, even if the issuer adopts a voting frequency policy that is consistent with a plurality of votes cast.

Consistent with Exchange Act Section 14A(b), any agreements or understandings between an acquiring company and the named executive officers of the issuer, where the issuer is not the acquiring company, are not required to be subject to the separate shareholder advisory vote.

### What Disclosure Is Required?

New Item 402(t) of Regulation S-K requires disclosure of named executive officers' golden parachute arrangements in a proxy statement for shareholder approval of a merger, sale of a company's assets, or similar transactions. This disclosure is only required in annual meeting proxy statements when an issuer is seeking to rely on the exception from a separate merger proxy shareholder vote by including the proposed Item 402(t) disclosure in the annual meeting proxy statement soliciting a Say-on-Pay vote.

Golden Parachute compensation must be disclosed in a table along with accompanying footnotes and narrative disclosure. The new table is set forth below:

#### Golden Parachute Compensation

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

The table would quantify cash severance payments, the value of equity awards that are accelerated or cashed out;<sup>7</sup> pension and nonqualified deferred compensation enhancements, perquisites, and other personal benefits; and tax reimbursements. The "Other" column also must include any additional compensation that is not included in any other column. Separate footnote identification of amounts attributable to "single trigger" and "double trigger" arrangements is also required. The table requires quantification with respect to any type of compensation, whether present, deferred, or contingent, that is based on or relates to an acquisition, merger, consolidation, sale, or other disposition of all or substantially all assets.

Item 402(t) of Regulation S-K also requires issuers to describe any material conditions or obligations applicable to the receipt of payment, including but not limited to non-compete, non-solicitation, non-disparagement or confidentiality agreements, their duration, and provisions regarding waiver or breach. Disclosure of the specific circumstances that would trigger payment, whether the payments would be lump sum or annual, and their duration, and by whom the payments would be provided, and other material factors regarding each agreement is also required. The narrative items are modeled on the narrative disclosure required with respect to termination

<sup>7</sup> If the Item 402(t) disclosure is included in a merger proxy statement, the value of equity awards is calculated using the consideration per share, if such value is a fixed dollar amount, or otherwise the average closing price per share over the first five business days following the first public announcement of the transaction. If the issuer elects to include the Item 402(t) disclosure in a proxy statement for an annual meeting, then the value of the equity awards is calculated using the closing market price as of the last business day of the issuer's last completed fiscal year.

and change-in-control agreements. Separate disclosure or quantification with respect to compensation disclosed in the Pension Benefits Table and Nonqualified Deferred Compensation Table (unless such benefits are enhanced in connection with the transaction), previously vested equity awards, and compensation from bona fide post-transaction employment agreements entered into in connection with the merger or acquisition is not required.

### How Does the Exception for the Say-on-Golden Parachute Vote Apply?

Issuers that wish to take advantage of the ability to exclude a Say-on-Golden Parachute vote in connection with a future vote on a merger or similar transaction must voluntarily include the Item 402(t) disclosures in proxy statements for annual meetings at which a Say-on-Pay vote will be held.<sup>8</sup> However, if there are changes to the arrangements after the date of the annual meeting or if new arrangements are adopted that were not subject to a prior Say-on-Pay vote, then a Say-on-Golden Parachutes vote will still be required. In that case, the vote is required only with respect to the amended golden parachute payment arrangements.

### What Additional Forms Require Golden Parachute Compensation Disclosure?

Additional forms, schedules, and disclosure requirements have been amended in order to address golden parachute compensation, such as Schedule 14A, Schedule 14C, Forms S-4 and F-4, Schedule 14D-9, Schedule 13E-3, and Item 1011 of Regulation M-A. The SEC adopted an amendment to Schedule TO in order to clarify that Item 402(t) disclosure is not required in third-party bidders' tender offer statements, so long as the subject transactions are not also Rule 13e-3 going-private transactions. Issuers filing solicitation/recommendation statements on Schedule 14D-9 in connection with third-party tender offers will be obligated to provide the disclosure required by Item 402(t) of Regulation S-K.

## PRELIMINARY PROXY STATEMENT REQUIREMENTS

The SEC amended Rule 14a-6(a) to add any shareholder advisory votes on executive compensation, including the Say-on-Pay or Say-on-Frequency votes, to the list of items that will not trigger the requirement to file a preliminary proxy statement with the SEC. This amendment encompasses an advisory vote on executive compensation that is not required by Exchange Act Section 14A.

## NO BROKER DISCRETIONARY VOTING

The adopting release notes that Section 951 of the Dodd-Frank Act amended Exchange Act Section 6(b) to prohibit broker discretionary voting of uninstructed shares with respect to a Say-on-Pay or a Say-on-Frequency vote. The SEC also noted in footnote 187 of the Adopting Release that New York Stock Exchange Rule 452 already prohibited broker discretionary voting in acquisition matters prior to enactment of the Dodd-Frank Act.

## INTERACTION WITH THE TARP SAY-ON-PAY REQUIREMENTS

For those issuers that have received financial assistance under the TARP and who have indebtedness outstanding under the TARP, the vote to approve executive compensation under Rule 14a-20 would satisfy the Say-on-Pay vote requirement. Once these issuers have repaid all outstanding indebtedness under the TARP, they would have to include a Say-on-Pay vote under Exchange Act Section 14A and Rule 14a-21(a) for the first annual meeting after the issuer has repaid all outstanding indebtedness. These issuers would not have to provide for a Say-on-Frequency vote as long as they still have indebtedness outstanding under the TARP, given that the Emergency Economic Stabilization Act, as amended, already requires an annual Say-on-Pay vote for TARP recipients.

<sup>8</sup> If an issuer includes the Item 402(t) disclosure in the annual meeting proxy statement, then the issuer also must include the termination and change-in-control disclosure required by Item 402(j) of Regulation S-K.

## SMALLER REPORTING COMPANIES

As noted above, the SEC is providing a temporary exemption from the Say-on-Pay and Say-on-Frequency vote requirements for smaller reporting companies. Such issuers will not be required to conduct either a Say-on-Pay vote or a Say-on-Frequency vote until the first annual or other meeting of shareholders occurring on or after January 21, 2013. No changes were made to the scaled disclosure requirements as a result of the Say-on-Pay and Say-on-Frequency votes, and thus smaller reporting companies will not be required to include a CD&A in order to comply with the new rules. Pursuant to Item 402(o) of Regulation S-K, however, smaller reporting companies are required to provide a narrative description of any material factors necessary to an understanding of the information in the Summary Compensation Table, and if consideration of prior Say-on-Pay votes is such a factor, disclosure would be required.

## CONCLUSION

The SEC's adopting release provides helpful guidance on how the statutory provisions are to be interpreted for this proxy season. Issuers will be concerned with the results of Say-on-Pay and Say-on-Frequency votes, and as a result they will be exploring increased engagement with shareholders and more effective proxy statement disclosures as a means of developing sufficient shareholder support. In this regard, issuers should be re-evaluating their CD&A for clarity, and consider whether an executive summary of the CD&A and/or supporting statements for Say-on-Pay and Say-on-Frequency votes should be included in the proxy statement. These enhanced disclosures can set forth the reasons that shareholders should consider before voting on the Say-on-Pay and Say-on-Frequency resolutions.

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