

January 28, 2011 | Posted By

[Some Interesting New Developments as SEC Adopts Final Say-on-Pay Rules](#)

In accordance with the [Dodd-Frank Wall Street Reform and Consumer Protection Act](#) (the "Reform Act") and its own October 2010 [proposed rules \(Release No. 33-9153\)](#) (the "Proposed Rules"), the Securities and Exchange Commission (the "SEC") on January 25, 2011 [announced](#) its adoption by a 3-2 vote of [final regulations for shareholder advisory votes on executive compensation \("Say-on-Pay"\) and golden parachute compensation \(Release No. 33-9178\)](#) (the "Final Rules").

As we previously commented (see our blog from [October 21, 2010 "Time to Get Ready for Say-on-Pay as SEC Releases Proposed Rules"](#)), the Reform Act implemented numerous new laws affecting executive compensation and corporate governance at publicly-held companies. Section 951 of the Reform Act requires that publicly held corporations provide their shareholders with the ability to render separate advisory votes to approve: (1) executive compensation ("Say-on-Pay"), (2) the frequency of Say-on-Pay votes ("Say-on-Frequency"), and (3) golden parachute arrangements for the company's named executive officers ("NEOs") in connection with merger/acquisition and other similar ("M&A") transactions ("Say-on-Golden Parachutes"). The shareholder votes are advisory in effect and are not binding on the company or its board of directors. The Reform Act also gave the SEC the authority to exempt certain companies, such as smaller reporting companies, from these requirements.

CHANGES FROM PROPOSED RULES

The Final Rules, while largely adopting the Proposed Rules, nevertheless do provide a few notable changes from the Proposed Rules, including:

- **Say-on-Pay and Say-on-Frequency** - The Final Rules clarify that the Say-on-Pay and Say-on-Frequency advisory shareholder votes need to be included in a company's proxy statement only for annual or other shareholder meetings at which directors are being elected.
 - The Final Rules require a company to include in its proxy materials the current frequency of its Say-on-Pay advisory shareholder vote (e.g., annual, every other year, or every three years) and to also state when the next Say-on-Pay vote will occur. These disclosures are not required in the proxy statement for the first Say-on-Pay and Say-on-Frequency votes.
 - The Final Rules provide an instruction that a company's resolution text for the Say-on-Pay vote must indicate that such vote is to approve the compensation of the company's NEOs as disclosed pursuant to Item 402 of Regulation S-K. While the Final Rules do not mandate specific language for this resolution, the Final Rules do provide a non-exclusive example of a resolution that will satisfy the applicable requirements. The sample resolution text provided in the Final Rules is: "*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.” [NTD: I would think lawyers like us are going to want to modify that resolution to say something like “hereby APPROVED for purposes of Section 14A(a) of the Securities Exchange Act of 1934, as amended.]

- The Final Rules permit a company to exclude a shareholder proposal that would provide a Say-on-Pay vote or seeks future Say-on-Pay votes or that relates to Say-on-Frequency votes, provided the company has adopted a policy on the Say-on-Frequency votes that is consistent with the *majority* of votes cast in the most recent vote (as opposed to the *plurality* standard contained in the Proposed Rules).
 - Since the majority vote standard is now required, it is therefore possible that no single frequency choice will receive a majority of votes and as a result, such companies may not be able to exclude subsequent shareholder proposals regarding Say-on-Pay matters even if they adopt a policy on frequency that is consistent with the plurality of votes cast.
- **Relief for Smaller Reporting Companies** - The Final Rules adopted a temporary two-year delayed implementation of the Say-on-Pay and Say-on-Frequency votes for smaller reporting companies (*i.e.*, companies with a public float of less than \$75 million). Accordingly, smaller reporting companies are not required to conduct these two shareholder advisory votes until annual meetings occurring on or after January 21, 2013. Smaller reporting companies did not, however, receive an exemption from the Say-on-Golden Parachutes compensation vote.
- **Transactions Requiring Say-on-Golden Parachutes Vote and Related Disclosure** - A Say-on-Golden Parachutes vote and related disclosure on golden parachute compensation is required to be included in the proxy solicitation in connection with M&A transactions. The Say-on-Golden Parachutes compensation disclosure (but not its advisory vote) is required in connection with other transactions, including Rule 13e-3 going-private transactions and third-party tender offers, so that the golden parachute compensation information is available for shareholders no matter the structure of the transaction. However, the Final Rules now exempt bidders in third-party tender offers from the golden parachute compensation disclosure requirement (although companies filing solicitation/recommendation statements on Schedule 14D-9 in connection with third-party tender offers will be obligated to provide this additional disclosure).
- **Compliance date for Say-on-Golden Parachutes Vote and Related Disclosure** - All companies, including smaller reporting companies, are required to comply with the Say-on-Golden Parachutes compensation shareholder advisory vote and related disclosure requirements in proxy statements and other schedules and forms initially filed on or after April 25, 2011.
- **Form 8-K Disclosure of Frequency Determination** - Under existing disclosure rules, companies must disclose the results of shareholder votes within four business days of the vote. The Final Rules now require a company to disclose its decision regarding how frequently it will conduct Say-on-Pay votes in light of the voting results on Say-on-Frequency. Under amended item 5.07 of Form 8-K, this new disclosure will be included in an amendment to the company's prior Form 8-K filing that reported the Say-on-Frequency vote. This amended Form 8-K must be filed no later than the earlier of (i) 150 calendar days after the date of the annual meeting at which the Say-on-Frequency vote took place or (ii) 60 calendar days prior to the deadline for submission of Rule 14a-8 shareholder proposals for

the subsequent annual meeting. This is a change from the Proposed Rules which would have required disclosure of such decision either in the Form 10-Q or Form 10-K.

Below is a brief overview of the Final Rules (additional provisions which remain unchanged from the Proposed Rules are described in our [October 21, 2010 blog](#)):

SHAREHOLDER ADVISORY SAY-ON-PAY VOTE

- **Generally**

- **What:** (*Final Rule 14a-21(a)*). A separate shareholder advisory vote to approve the compensation of NEOs is required to be provided in a company's proxy statement for annual or other shareholder meetings at which directors are being elected (and in which executive compensation disclosure is required to be disclosed under Item 402 of Reg. S-K) at least once every three calendar years.
- **When:** A Say-on-Pay vote is required for a company's (other than smaller reporting companies) first annual or other meeting of shareholders occurring on or after January 21, 2011.
 - **Smaller reporting companies** - A Say-on-Pay vote will be required for a smaller reporting company's first annual or other meeting of shareholders occurring on or after January 21, 2013.

- **Required Disclosures**

- **Item 24 of Schedule 14A; Item 402(b) of Reg. S-K; Form 8-K** - Companies are required to disclose in their proxy statement that there is a separate Say-on-Pay vote and to explain the general effect of the Say-on-Pay vote including whether the vote is non-binding (which it almost certainly would be).
- Companies will need to describe in their Compensation Discussion and Analysis ("CD&A") section whether, and if so, how their compensation policies and decisions have considered and taken into account the results of the most recent Say-on-Pay vote.
- Companies are required to disclose in their proxy statements that contain a shareholder advisory vote on executive compensation the current frequency of their Say-on-Pay vote (*e.g.*, annual, every other year, or every three years) and must also disclose when the next Say-on-Pay vote will occur. These disclosures are not required in the proxy statement for the first Say-on-Pay and Say-on-Frequency votes.
- In accordance with the existing requirements under Form 8-K, companies are required to disclose the results of the Say-on-Pay vote within four business days of the shareholder meeting.

SHAREHOLDER ADVISORY SAY-ON-FREQUENCY VOTE

- **Generally**

- What: (Final Rule 14a-21(b)). Companies are required, not less frequently than once every six calendar years, to provide a separate shareholder advisory vote in proxy statements for annual or other shareholder meetings at which directors are being elected (and in which executive compensation is required to be disclosed under Item 402 of Reg. S-K) on whether the Say-on-Pay vote should occur annually, every other year or every three years. Proxy statements need to provide shareholders with four alternative choices: every 1, 2, or 3 years for the Say-on-Frequency vote or for shareholders to abstain from the vote.
- When: A Say-on-Frequency vote is required for a company's (other than smaller reporting companies) first annual or other meeting of shareholders occurring on or after January 21, 2011.
 - Smaller reporting companies - A Say-on-Frequency vote will be required for a smaller reporting company's first annual or other meeting of shareholders occurring on or after January 21, 2013.

- **Required Disclosures**

- Item 24 of Schedule 14A; Amendments to Rule 14a-4 and Form 8-K - Companies are required to disclose in the proxy statement that they are providing a separate shareholder vote on the frequency of the Say-on-Pay vote and to explain the general effect of the Say-on-Frequency vote including whether the vote is non-binding (we expect most companies will elect a non-binding vote).
 - In accordance with the existing requirements under Form 8-K, companies are required to disclose the results of the Say-on-Frequency vote within four business days of the shareholder meeting.
 - Companies are also required under amended item 5.07 of Form 8-K to disclose, by filing an amendment to their prior Form 8-K that reported the Say-on-Frequency vote results, their decision on how frequently they will conduct the Say-on-Pay vote in light of the results of the Say-on-Frequency vote. This amended Form 8-K must be filed no later than the earlier of (i) 150 calendar days after the date of the annual meeting in which the vote took place or (ii) 60 calendar days prior to the deadline for submission of Rule 14a-8 shareholder proposals for the subsequent annual meeting.

- **Ability to Exclude Shareholder Proposals related to Say-on-Pay or Say-on-Frequency Votes**

- Amendment to Rule 14a-8 - As an incentive for a company to follow its shareholders' wishes as expressed in the most recent Say-on-Frequency vote, a company will be able to exclude shareholder proposals involving shareholder votes on NEO executive compensation or involving the frequency of such a vote from its proxy statement if: (i) a single frequency choice received a majority of the votes, and (ii) a company adopts a frequency for its Say-on-Pay votes that is consistent with such majority of votes cast in its most recent Say-on-Frequency vote.

SHAREHOLDER ADVISORY VOTE ON GOLDEN PARACHUTE ARRANGEMENTS

- **Generally**

- **What:** (*Final Rule 14a-21(c) and Amendments to Schedule 14A*). A golden parachute compensation disclosure is required to be included in the proxy solicitation in connection with M&A transactions and other transactions including Rule 13e-3 going-private transactions and third-party tender offers. A separate shareholder advisory vote on approving NEO golden parachute arrangements will also need to be included in M&A transactions proxy solicitations (but not in connection with other transactions including Rule 13e-3 going-private transactions and third-party tender offers) in which shareholders were being asked to approve the company's corporate transaction. The advisory vote is only cast with respect to the golden parachute arrangements required to be disclosed by the Reform Act with respect to the specific transaction.
- **When:** The separate shareholder advisory Say-on-Golden Parachutes vote and related disclosure is required for M&A and other transaction proxy solicitations initially filed on or after April 25, 2011.

- **Required Disclosures - Golden Parachute Compensation Table**

- *Item 402(t) of Reg. S-K* - Golden parachute arrangements for NEOs need to be described in proxy or consent solicitations issued in connection with M&A, going-private, third-party tender offers and similar transactions. Bidders in a third-party tender offer (so long as such offers are not also Rule 13e-3 going-private transactions) and foreign private issuers are exempt from the golden parachute compensation disclosure obligations.
- Companies are required to disclose in their proxy solicitation, in both narrative and tabular form, the golden parachute arrangements of the NEOs. The Final Rules mandate using a specific "Golden Parachute Compensation" columnar table with elements that resemble the Summary Compensation Table. However, companies are permitted to add additional named executive officers and additional columns or rows to the tabular disclosure, so long as such disclosure is not misleading. Note that the Golden Parachute Compensation table would report on the applicable golden parachute compensation arrangements for the NEOs of *both* the target and acquiring company.
- The Final Rules also provide that a company can (but does not have to) satisfy the requirement to disclose potential change in control compensation payments (required under Item 402(j) of Reg. S-K) in its annual proxy statement by providing the disclosure required under the new golden parachute compensation disclosure Item 402(t). The company must, however, still include disclosure in accordance with Item 402(j) about payments that may be made to NEOs upon termination of employment outside of a change in control of the company.

- **Important Exception**

- *Final Rule 14a-21(c)* - As permitted by the Reform Act, a separate shareholder advisory vote on golden parachute arrangements is not required in the M&A proxy solicitation if disclosure of the same golden

parachute compensation arrangements had been fully included in a previous Say-on-Pay vote (whether or not the shareholders had previously approved the executive compensation). However, if there have been any changes to such golden parachute arrangements (excluding for this purpose movements in the Company's stock price that had occurred over time), then such changes would trigger the disclosure and shareholder vote requirements for the new/revised golden parachute arrangements in the M&A proxy solicitation. In such case, the required disclosure will include two separate tables with one disclosing all of the golden parachute arrangements and the other table disclosing the new/revised arrangements that are subject to the shareholder advisory vote.

- The Final Rules provide that changes that result only in a reduction in value of the total compensation payable will not require a new shareholder vote;
- The Final Rules clarify that changes in compensation between the time of a regular Say-on-Pay vote and an actual corporate transaction and where such changes result from there being a new NEO, or additional grants of equity compensation in the ordinary course or increases in salary, are deemed to be significant changes to the golden parachute compensation disclosure and will trigger a Say-on-Golden Parachutes vote on such new arrangements.

TECHNICAL CLARIFICATIONS AND TRANSITIONAL ITEMS

- ***No Requirement to file Preliminary Proxy.*** The Final Rules provide that any shareholder advisory vote on executive compensation, including Say-on-Pay and Say-on-Frequency votes, will not trigger a preliminary filing of a proxy statement.
- ***No Discretionary Broker Voting.*** The Final Rules reiterate that broker discretionary voting of uninstructed shares will not be permitted for the Say-on-Pay vote or the Say-on-Frequency vote.
- ***No Added Requirement for TARP Companies.*** Companies with indebtedness under TARP already have a current obligation to conduct a shareholder vote on executive compensation and therefore the Final Rules provide that TARP companies will be exempt from having to conduct a Say-on-Pay or Say-on-Frequency vote.

What Next?

Although these executive compensation shareholder votes are only advisory in nature, companies will have to explain whether/how the voting results influences later decisions and actions on executive pay. Moreover, a negative Say-on-Pay vote is presumably something that a company and its executive officers, board of directors and compensation committee will want to avoid. Therefore, as we have previously commented (see for example our blogs from [January 20, 2011 "Companies Should Not Take Lightly the Need for Full Compliance with the SEC's Executive Compensation Disclosure Rules"](#), [October 21, 2010 "Time to Get Ready for Say-on-Pay as SEC Releases Proposed Rules"](#)), and [July 26, 2010 "The Regulatory March to Reform Executive Compensation Practices Takes Another Step Forward"](#)), companies should evaluate their executive compensation processes, arrangements and disclosures and seek to improve them if/as needed.

In order to better assist shareholders in understanding the executive compensation programs and policies and to improve the likelihood of receiving a positive Say-on-Pay vote, companies should consider including an executive summary in the CD&A that clearly highlights the company's pay and governance practices and which provides a clear link between the company's

performance and the resulting pay to its executives. Moreover, companies may want to also consider including a supporting statement with the Say-on-Pay proposal which enumerates the Board's key reasons for recommending that shareholders approve the compensation of the company's NEOs.

In preparing for the Say-on-Pay and Say-on-Frequency votes, companies may also want to start evaluating, if they have not yet already done so, the following:

- What Say-on-Frequency to recommend to shareholders and the reasons for the recommended frequency;
- Whether or not to use the sample Say-on-Pay resolution language that was included in the Final Rules and if not then what resolution text will be used instead; and
- Whether or not to include the Item 402(t) golden parachute compensation disclosures in the company's next annual proxy statement.

As Say-on-Pay is new and still evolving, we expect that there will be further interpretative guidance and instructions from the SEC forthcoming throughout this 2011 proxy season.

If you have any questions regarding this information, please contact [Greg Schick](#) at (415) 774-2988 or [Nicole Slattery](#) at (858) 720-7467.

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