ALERTS AND UPDATES

SEC Proposes Say-on-Pay and Say-on-Golden-Parachute Rules

November 5, 2010

On October 28, 2010, the U.S. Securities and Exchange Commission (the "SEC") issued Release No. 34-63124, proposing new rules to implement Section 14A of the Securities Exchange Act of 1934 (the "Exchange Act"), which was created under Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law on July 21, 2010. The new rules would require a public company[1] to conduct separate shareholder advisory votes on executive compensation and "golden parachute" arrangements, as disclosed pursuant to Item 402 of Regulation S-K. The votes cast by shareholders pursuant to Section 14A will be non-binding on the company and its board of directors and will not create or change the fiduciary duties of the company or its board of directors. The SEC will be accepting public comments on the proposals until November 18, 2010.

Say-on-Pay Votes

Section 14A(a)(1) of the Exchange Act requires that, at least once every three years at an annual meeting of shareholders (or another meeting of shareholders for which the SEC rules require Item 402 disclosure of executive compensation), a public company afford its shareholders the right to a separate, non-binding vote to approve the executive compensation of the company's named executive officers[2] required to be disclosed in the proxy statement relating to such meeting pursuant to Item 402 of Regulation S-K[3] (a "Say-on-Pay Vote").

Say-on-Frequency Votes

Under Section 14A(a)(2), at least once every six years, a company must also submit a separate non-binding resolution allowing shareholders the opportunity to vote on whether the Say-on-Pay Vote will occur every one, two or three years (a "Say-on-Frequency Vote").[4]

Say-on-Golden-Parachute Votes

Section 14A(b)(1) of the Exchange Act requires that, in connection with a meeting at which shareholders are asked to approve a proposed acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all the assets of a company (a "change of control transaction"), the company must disclose in its proxy statement all compensation agreements and understandings between the soliciting company and any of its named executive officers (or any named executive officers of the acquiring company, if the soliciting company is not the acquiring company) that are based on or related to the transaction (so called "golden parachute" arrangements). Section 14A(b)(2) requires the company to afford its shareholders the opportunity to approve the golden parachute arrangements in a separate, non-binding shareholder vote (a "Say-on-Golden-Parachute Vote").

However, the company need not submit its golden parachute arrangements to shareholders for approval at the meeting related to the change of control transaction if: (i) the golden parachute arrangements were previously subject to a Say-on-Pay Vote under Section 14A(a);[5] (ii) the disclosure requirements under Item 402(t) of Regulation S-K (as outlined below) were satisfied in the proxy statement relating to the meeting at which shareholders are afforded the Say-on-Pay Vote;[6] and (iii) the terms of the golden parachute agreements or arrangements that were previously subject to the Say-on-Pay Vote have not been modified.[7]

Additional Disclosure Requirements Related to Golden Parachutes

The SEC's rule proposals will require more detailed disclosure of golden parachutes in the context of a change of control transaction than the SEC's rules currently require.[8] Under Section 14A(b), the disclosure in the proxy statement must include a clear and simple presentation of the aggregate total of all compensation payable to any named executive officer based on or related to the change of control transaction and the conditions upon which the compensation may be paid or become payable. The SEC's proposed rules would require disclosure of named executive officers' golden parachute arrangements in both tabular and narrative formats that include separated items for the elements of the officers' compensation.[9]

Pursuant to Item 402(t) of Regulation S-K, a company would have to describe all material conditions and obligations applicable to the receipt of any executive compensation payments (such as noncompete and confidentiality agreements), a description of the specific circumstances that

would trigger such payments, whether the payments would or could be paid in a lump sum or annually, the duration of the payments, who would provide the payments and material factors about each golden parachute arrangement.

Timing Requirements Under Section 14A

A company will be required to include both the Say-on-Pay Vote and the Say-on-Frequency Vote in its proxy statement for the first annual meeting (or other shareholder meeting) occurring after January 21, 2011, regardless of whether the SEC has adopted proposed rules to implement Section 14A. On the other hand, a company will not be required to submit Say-on-Golden-Parachute Votes to shareholders at shareholder meetings related to change of control transactions until the later of January 21, 2011, or the time when rules implementing Section 14A have become effective.

Section 14A Vote Language

The SEC's rule proposal does not express specific language or a form of resolution that must be presented for the shareholder advisory votes required by Section 14A. The SEC has stated only that the respective votes must relate to all executive compensation disclosed pursuant to Item 402 of Regulation S-K.[10]

Disclosure of the Effects of Section 14A Advisory Votes

Disclosure of Non-binding Effect. Under the proposed SEC rules, a company must disclose the non-binding nature of the Section 14A advisory votes in the proxy statements relating to meetings at which shareholders are entitled to cast such votes.

Disclosure in Compensation Discussion and Analysis. A company that is required to include a Compensation Discussion and Analysis section in its proxy statement pursuant to Item 402 of Regulation S-K will have to include in that analysis disclosure of whether, and, if so, how, the company has considered the results of previous Section 14A advisory votes in determining its executive compensation policies and decisions.[11] Although a smaller reporting company does not have to include a Compensation Disclosure and Analysis section in its proxy statement, it may have to include disclosure of the effects that Section 14A advisory votes have had on its executive compensation policies and decisions as a result of Item 402(o) of Regulation S-K, which requires a smaller reporting company to provide a description of any material factors necessary to an understanding of the information disclosed in its Summary Compensation Table.

Disclosure in Form 10-Q and Form 10-K. Under the proposed rules, a company will have to disclose in its quarterly report on Form 10-Q covering the period in which a Section 14A advisory vote occurs (or in its annual report on Form 10-K if the vote occurs in the company's fourth quarter) its decision regarding the frequency of its Say-on-Pay Votes in light of the results of the Say-on-Frequency Vote.

No Preliminary Proxy Statement Required

The SEC has proposed to amend Rule 14a-6(a) of the Exchange Act such that Say-on-Pay Votes and Say-on-Frequency Votes will not trigger the requirement that a company file its proxy statement in preliminary form, so long as none of the other matters in the proxy statement trigger such a filing under Rule 14a-6(a).

No Broker-Discretionary Voting

Under the proposed rules, brokers will not be permitted to vote uninstructed shares in Say-on-Pay Votes or Say-on-Frequency Votes.[12]

Annual Reporting of the Proxy Voting Records of Registered Management Investment Companies

On October 28, 2010, the SEC also published proposed Rule 14Ad-1 under the Exchange Act and the Investment Company Act of 1940 in Release No. 34-63123. If adopted, Rule 14Ad-1 will require an institutional investment manager that is subject to Section 13(f)[13] of the Exchange Act ("Section 13(f)") to report to the SEC, at least annually on Form N-PX, how it voted on any shareholder advisory votes pursuant to Section 14A, unless such votes are otherwise required to be publicly reported by an SEC rule or regulation. Under proposed Rule 14Ad-1, an institutional investment manager would be required to report the Section 14A advisory votes only with respect to securities for which it had or shared the power to vote, or had or shared voting power over the particular Section 14A advisory vote, without regard to whether it has voting power over other matters.

Rule 14Ad-1 will require institutional investment managers to report the Section 14A advisory votes on an annual basis, not later than August 31 of each year, for the most recent 12-month period ended June 30. In order to implement Rule 14Ad-1, the SEC has also proposed to amend Form N-PX,[14] which, as amended, would require an institutional investment manager subject to Section 13(f) to disclose the number of shares over which it had or shared voting power, the number of shares voted, and how the shares were voted by it in any Section 14A advisory vote. To prevent duplicative reporting, the amendments to Form N-PX would permit a single institutional investment manager to report Section 14A advisory votes in cases where multiple institutional investment managers share voting power, and an institutional investment manager to satisfy its reporting obligations by reference to the Form N-PX report of a fund that includes the manager's Section 14A advisory votes.
The SEC will be accepting public comments regarding the proposals outlined above until November 18, 2010.

About Duane Morris

Duane Morris has an online **Financial Services Reform Center** – www.duanemorris.com/FinancialReform – which includes videos and the firm's comprehensive series of *Alerts* analyzing the provisions of the Dodd-Frank Act and emerging policies, as well as links to relevant government websites. Duane Morris' attorneys are monitoring the rules and regulations released under the Dodd-Frank Act, as well as the regulatory agencies' interpretive guidance, and continuously update the Financial Services Reform Center.

For Further Information

If you have any questions regarding the proposed say-on-pay, say-on-frequency, and say-on-golden-parachute rules discussed above, including how they may affect your company, please contact any member of the Securities Law Practice Group or the lawyer in the firm with whom you are regularly in contact.

Notes

1. The SEC's proposed rules would apply to issuers who have a class of equity securities registered under Section 12 of the Exchange Act and are subject to the SEC's proxy rules.
2. As defined in Item 402(a)(3) of Regulation S-K.
3. Under the proposed rules, smaller reporting companies will remain subject to scaled executive-compensation disclosure requirements, and thus will not need to disclose Compensation Discussion and Analysis narratives in their annual proxy statements in order to comply with Section 14A.
4. The SEC has not prescribed a standard for companies to determine which frequency has been adopted by the shareholders in a Say-on-Frequency Vote. However, a shareholder proposal that would provide a Say-on-Pay Vote, or seeks future Say-on-Pay Votes, or that relates to the frequency of Say-on-Pay Votes may be excluded from the proxy materials of a company if it has adopted a policy on the frequency of Say-on-Pay Votes that is consistent with the plurality of votes cast by shareholders in the most recent Say-on-Frequency Vote. For example, if in the most recent Say-on-Frequency Vote the largest number of votes are cast for a two-year frequency for future Say-on-Pay Votes, and the company discloses that it has approved a policy to hold a Say-on-Pay Vote every two years, any shareholder proposal seeking a different frequency could be excluded so long as the company seeks a Say-on-Pay Vote on executive compensation every two years and provides a vote on frequency at least once every six years as required by Section 14A(a)(2).
5. Whether or not the vote was actually approved by shareholders is not considered.
6. Companies may wish to voluntarily include Item 402(t) disclosure with their other executive compensation disclosure in annual meeting proxy statements soliciting Say-on-Pay Votes, so that they need not present a Say-on-Golden-Parachute Vote and associated required disclosures to shareholders in a potential subsequent merger or acquisition transaction.
7. New golden-parachute arrangements and revised terms of such arrangements which were previously subject to a Section 14A(a)(1) shareholder vote would be subject to a Say-on-Golden-Parachute Vote under Section 14A(b).
8. In the context of a merger, Item 5 of Schedule 14A requires the disclosure of the substantial interest of any person who has been a director or executive officer since the beginning of the last fiscal year. Item 402(j) of Regulation S-K and Item 8 of Schedule 14A require companies to disclose in their annual reports and annual-meeting proxy statements payments (and circumstances regarding such payments) that may be made to named executive officers in connection with a change of control.
9. This table must include cash severance payments; 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; pension and nonqualified deferred-

compensation benefit enhancements; perquisites and other personal benefits and health and welfare benefits; tax reimbursements such as tax gross-ups; any additional compensation related to the transaction; and the aggregate total of all compensation related to the transaction.

10. The compensation of directors, as disclosed pursuant to Items 402(k) and (r) of Regulation S-K, as well as the risk management and risk-taking incentives policies and practices of companies disclosed pursuant to Item 402(s) of Regulation S-K will not be subject to a shareholder advisory vote under Section 14A.
11. Reporting companies are currently required to disclose, pursuant to Item 5.07 of Form 8-K, the results of a shareholder vote within four business days after the end of the meeting at which the vote is held. The SEC is not proposing any additional disclosure on Form 8-K for a company to discuss the results of the votes required by Section 14A, though companies may voluntarily provide additional disclosure.
12. Brokers are not permitted to vote uninstructed shares in connection with a merger or acquisition or acquisition transaction under the current rules of the national securities exchanges and thus have no discretion to vote uninstructed shares in a Say-on-Golden-Parachute Vote as well.
13. An institutional investment manager (as defined in Section 13(f)(6)(A) of the Exchange Act) is required to file reports under Section 13(f) if it exercises investment discretion with respect to accounts holding Section 13(f) securities having an aggregate fair market value on the last trading day of any month of any calendar year of at least $100 million.
14. See OMB Control No. 3235-0582.