Client Alert.

October 19, 2010

SEC Proposes Say-on-Pay Rules

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OVERVIEW

Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (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.

While Section 951 of the Dodd-Frank Act did not specifically mandate the adoption of rules to implement the advisory vote on executive compensation provisions, the SEC has decided to propose rules that will facilitate the implementation of the new requirements. Under the proposed rules specified in Release 33-9153 (the "Proposing Release"), public companies subject to the proxy rules would be required to:

- provide their shareholders with a Say-on-Pay vote and a Say-on-Frequency vote, along with additional disclosure about the Say-on-Frequency vote;
- provide shareholders with a Say-on-Golden Parachute vote; and
- provide additional disclosure of golden parachute arrangements in merger proxy statements (and potentially in proxy statements seeking a Say-on-Pay vote).

The SEC also proposed rules in Release 34-63123 that would require that institutional investment managers report their votes on Say-on-Pay, Say-on-Frequency, and Say-on-Golden Parachutes at least annually, unless the votes are otherwise required to be reported publicly by SEC rules.

TIMING AND TRANSITION ISSUES

Comments on the proposals are due by November 18, 2010. It is expected that the SEC would be in a position to adopt the final rules by as early as January 2011; however, it appears unlikely that the final rules will be effective for all proxy statements required to be filed for annual meetings taking place on or after January 21, 2011. The SEC confirms in the Proposing Release that a company must include separate resolutions for the Say-on-Pay and Say-on-Frequency vote in any preliminary or definitive proxy statement filed for an annual meeting occurring on or after January 21, 2011, whether or not the SEC's proposed rules and amendments have been adopted by that time.

However, the SEC notes that because the statute requires SEC rulemaking with respect to the disclosure of golden

parachute compensation arrangements, the proposed disclosure that would be mandated under a new paragraph (t) of Item 402 of Regulation S-K and a separate shareholder resolution to approve golden parachute compensation arrangements would not be required for merger proxy statements until the implementing rules become effective.

The SEC notes the following important transition issues:

- Until the SEC takes final action to amend Rule 14a-6, the SEC would not object if an issuer did 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 SEC takes final action to amend Rule 14a-4, 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 services such as Broadridge are unable to accommodate the four choices in time for the vote, the SEC will not object if 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 if a solicited person does not select one of the three choices.

SAY-ON-PAY VOTE

The SEC proposes a new Rule 14a-21 to address the implementation of the advisory votes on executive compensation matters mandated by Section 951 of the Dodd-Frank Act. In many cases, the SEC took a similar approach to the rules that it adopted under the Emergency Economic Stabilization Act (the "EESA"), which required that financial institutions receiving government assistance submit a Say-on-Pay vote to their shareholders.

What Is Covered by the Resolution?

Under proposed Rule 14a-21(a), issuers who have a class of equity securities registered under Section 12 of the Securities Exchange Act of 1934 (the "Exchange Act") and are subject to the proxy rules would be required, not less frequently than once every three years, to provide for a shareholder advisory vote to approve the compensation of their named executive officers, as defined in Item 402(a)(3) of Regulation S-K, as such compensation is disclosed in Item 402 of Regulation S-K, including the Compensation Discussion and Analysis (the "CD&A"), the compensation tables, and the narrative executive compensation disclosures required by Item 402.

What Is Not Covered by the Resolution?

The shareholder advisory vote would not cover:

- the compensation of directors; and
- if an issuer includes the disclosure pursuant to Item 402(s) of Regulation S-K about the issuer's compensation policies and practices as they relate to risk management and risk-taking incentives, these policies and practices would not be subject to the shareholder advisory vote as they relate to the issuer's compensation for employees generally, with the one exception that if risk considerations are a material aspect of the issuer's compensation policies or decisions for named executives officers that must be discussed as part of the CD&A, then that disclosure would be considered by shareholders when they are voting on the Say-on-Pay resolution.

Wording of the Resolution

Proposed Rule 14a-21(a) does not require issuers to use specific language or a form of a resolution to be voted on by shareholders. However, the SEC cautions that the statute requires a vote "to approve the compensation of executives, as

disclosed pursuant to [Item 402 of Regulation S-K] or any successor thereto." Thus, a vote to approve a proposal on a different subject matter, such as only to approve the compensation policies or practice of the issuer, would not satisfy the requirement for a Say-on-Pay vote.

Additional Disclosure Item for the Proxy Statement

Proposed Item 24 of Schedule 14A would require disclosure in the proxy statement that the issuer is providing a separate shareholder vote on executive compensation, along with a brief explanation of the general effect of the vote, such as that the vote is nonbinding.

Additional CD&A Disclosure

The SEC proposes to amend Item 402(b) of Regulation S-K to require that issuers address in their CD&A whether, and if so, how their compensation policies and decisions have taken into account the results of shareholder advisory votes on executive compensation.

Solicitation of Comment

The SEC solicits comment on whether it should provide more specificity in its requirements with respect to the Say-on-Pay vote, such as whether to specify the exact form of the resolution, whether additional disclosure should be required (including with respect to the proposed CD&A disclosure requirement), whether the SEC should address which shares are entitled to vote on the resolution, and whether compliance dates should be adopted to phase-in the requirements.

SAY-ON-FREQUENCY VOTE

Under proposed Rule 14a-21(b), issuers would be required, not less frequently than once every six years, to provide for separate shareholder advisory votes in proxy statements for annual meetings to determine whether the Say-on-Pay vote will occur every one, two, or three years (beginning with meetings occurring on or after January 21, 2011). The proposed rule would clarify that the separate Say-on-Frequency vote would be required only in a proxy statement solicited for an annual or other meeting of shareholders for which SEC rules require executive compensation disclosure.

Four Choices for the Say-on-Frequency Vote

The SEC proposes that under the Say-on-Frequency vote contemplated by Item 14a-21(b), shareholders would be given four choices: whether the shareholder vote on executive compensation will take place every one, two, or three years, or to abstain from voting on the matter. The SEC expresses its view that Section 951 of the Dodd-Frank Act does not allow for alternative formulations, such as proposals that would provide shareholders with two substantive choices, such as to hold a Say-on-Pay vote every year or less frequently, or only one choice, such as a company proposal to hold the Say-on-Pay vote every two years. The SEC does note, however, that it expects the board of directors to include a recommendation as to how shareholders should vote on the Say-on-Frequency proposal, provided that the proxy card clearly provides the four choices referenced above and that shareholders are not specifically voting on the board's recommendation.

In order to permit the Say-on-Frequency vote with four choices, the SEC proposes to amend Rule 14a-4 to specifically allow proxy cards including a Say-on-Frequency vote to reflect the choice of one, two, or three years, or abstaining.

Voting Standard for Say-on-Frequency Votes

The SEC notes that, given the advisory nature of the Say-on-Frequency proposal, it is not necessary to prescribe a standard for determining which frequency has been adopted by shareholders, except that for the purposes of implementing the proposed amendments to Rule 14a-8 discussed below, the SEC proposes that a plurality of votes cast standard be utilized to determine which one of the substantive choices has been selected.

Solicitation of Comment

The SEC asks for comments as to whether the four choices for shareholders will be sufficiently clear for the Say-on-Frequency vote, and whether various service providers will be able to implement the proposed changes to the proxy card and related systems necessary to facilitate the four choices for the Say-on-Frequency vote.

Amendment to Rule 14a-8's Substantially Implemented Standard

The SEC proposes to add a note to Rule 14a-8(i)(10) that would clarify that shareholder proposals seeking an advisory shareholder vote on executive compensation or relating to the frequency of shareholder votes approving compensation could be excludable from an issuer's proxy statement as "substantially implemented" if the issuer has adopted a policy on the frequency of Say-on-Pay votes that is consistent with the result from the plurality of votes cast in the most recent shareholder vote taken in accordance with proposed Rule 14a-21(b). The SEC solicits comments on whether this proposed basis for exclusion is appropriate, whether it should be expanded, whether the plurality standard should be used, and whether the instruction to Rule 14a-8(i)(10) should be available if an issuer has materially changed its compensation program since the most recent Say-on-Pay vote or Say-on-Frequency vote.

Periodic Report Disclosure Regarding Say-on-Frequency Votes

The SEC proposes to amend Item 9B of Form 10-K and to add new Item 5(c) of Part II of Form 10-Q to require that an issuer disclose, in the Form 10-Q covering the period during which the shareholder advisory vote occurs, or in the Form 10-K if the advisory vote occurs during the issuer's fourth quarter, its decision regarding how frequently the issuer will conduct a Say-on-Pay vote in light of the results of the Say-on-Frequency vote. The SEC solicits comment on whether this disclosure is necessary and would provide timely notice to shareholders. As an interpretative matter, the SEC notes that the Form 8-K required under Item 5.07 could include additional disclosure regarding any shareholder votes required by Section 951 of the Dodd-Frank Act and how the results of these votes affect an issuer's plans for the future.

BROKER DISCRETIONARY VOTING

The Proposing Release notes that Section 957 of the Dodd-Frank Act amends Section 6(b) of the Exchange Act to prohibit broker discretionary voting of uninstructed shares in shareholder votes on executive compensation. The SEC notes that the exchanges have begun to amend their rules to implement this requirement, and as a result of these rule changes broker discretionary voting would not be permitted for a Say-on-Pay vote or a Say-on-Frequency vote.

EXCLUSION FROM THE REQUIREMENT TO FILE A PRELIMINARY PROXY STATEMENT

The SEC proposes to amend Rule 14a-6(a) to add Say-on-Pay and Say-on-Frequency votes to the list of items that do not trigger a preliminary proxy statement filing requirement. The SEC solicits comments on whether this amendment is appropriate and whether it should address any other separate shareholder votes on executive compensation.

SAY-ON-GOLDEN PARACHUTES

Disclosure Provisions for Golden Parachutes

The SEC proposes new paragraph (t) of Item 402 of Regulation S-K, which would require disclosure regarding golden parachute arrangements in proxy statements, consent solicitation statements, and other forms relating to an acquisition, merger, consolidation or proposed sale or disposition of all or substantially all of a company's assets, as well as 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.

Proposed Item 402(t) of Regulation S-K would require disclosure of named executive officers' golden parachute arrangements in both tabular and narrative formats. The SEC is proposing the following new table:

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							

The proposed table would quantify cash severance, equity awards that are accelerated or cashed out, pension and nonqualified deferred compensation enhancements, perquisites, and tax reimbursements. In addition, the proposed table would require disclosure and quantification of the value of any other compensation related to the transaction. The table would not require separate disclosure or quantification with respect to compensation disclosed in the Pension Benefits Table and Nonqualified Deferred Compensation Table, previously vested equity awards, or compensation from bona fide post transaction employment agreements to be entered into in connection with the merger or acquisition transaction. As proposed by the SEC, the table would require separate footnote identification of amounts attributable to "single-trigger" arrangements and amounts attributable to "double-trigger" arrangements, so that shareholders can readily discern these amounts. The tabular disclosure required by Item 402(t) would require quantification with respect to any agreements or understandings, whether written or unwritten, between each named executive officer and the acquiring company or the target company, concerning any type of compensation, whether present, deferred, or contingent, that is based on or

otherwise relates to an acquisition, merger, consolidation, sale, or other disposition of all or substantially all assets.

Proposed Item 402(t) of Regulation S-K would also require issuers to describe any material conditions or obligations applicable to the receipt of payment, including but not limited to noncompete, nonsolicitation, nondisparagement, or confidentiality agreements, their duration, and provisions regarding waiver or breach. The SEC has also proposed a requirement to provide a description of the specific circumstances that would trigger payment, whether the payments would or could be lump sum, or annual, and their duration, and by whom the payments would be provided, and any material factors regarding each agreement. The SEC notes that these proposed narrative items are modeled on the narrative disclosure currently required with respect to termination and change-in-control agreements.

Shareholder Approval of Golden Parachutes

The SEC proposed Rule 14a-21(c) would provide that if a solicitation is made by an issuer for a meeting of shareholders at which shareholders are asked to approve an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all the 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, unless such agreements or understandings have been subject to a shareholder advisory vote under Rule 14a-21(a). In accordance with Section 14A(b) of the Exchange Act, Rule 14a-21(c) notes that 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.

Additional amendments are also proposed to various rules and forms in order to accommodate the Say-on-Golden Parachute vote.

The SEC does not propose any specific form of the Say-on-Golden Parachute proposal and clarifies the advisory nature of such proposals. The SEC notes that the Item 402(t) disclosure would have to be provided at the time of the Say-on-Pay vote if an issuer is seeking to rely on the exception to providing for a separate Say-on-Golden Parachute vote at the time of a merger or other extraordinary transaction, and that the exception would only be available to the extent the same golden parachutes previously subject to a Say-on-Pay vote remain in effect.

Solicitation of Comments

The SEC solicits a number of comments about the scope and specific elements of Item 402(t), and asks whether the disclosure would be useful in annual meeting proxy statements in the absence of an actual transaction. The SEC also solicits comments on the operation of the exception to provide for a separate Say-on-Golden Parachute vote in the merger proxy statement by subjecting the golden parachutes to the Say-on-Pay vote at an annual meeting.

INTERACTION WITH EESA REQUIREMENTS

For those issuers that have received financial assistance under the Troubled Asset Relief Program ("TARP") and who have indebtedness outstanding under the TARP, the SEC indicates in the Proposing Release that the vote to approve executive compensation under Rule 14a-20 (which the SEC adopted in 2009) would satisfy the requirement for a Say-on-Pay vote under Rule 14a-21(a). Once these issuers have repaid all outstanding indebtedness under the TARP, they would have to include a Say-on-Pay vote under the Dodd-Frank Act and proposed Rule 14a-21(a) in a proxy statement for the first annual meeting after the indebtedness is repaid. These issuers would also not have to provide for a Say-on-

Frequency vote as long as they still have indebtedness outstanding under the TARP, given that the EESA already requires an annual Say-on-Pay vote.

SMALLER REPORTING COMPANIES

The SEC has not proposed to exempt smaller reporting companies from the Say-on-Pay, Say-on-Frequency and Say-on-Golden Parachute vote requirements, although the SEC does solicit comments on whether such an exemption would be appropriate. The SEC has proposed an instruction to Rule 14a-21 providing that smaller reporting companies that are eligible to provide scaled disclosure in accordance with Item 402(l) of Regulation S-K are not required to include a CD&A in their proxy statements in order to comply with proposed Rule 14a-21. The instruction would further provide that for smaller reporting companies, the Say-on-Pay vote required by proposed Rule 14a-21(a) must be to approve the compensation of the named executive officers as disclosed pursuant to Item 402(m) through (q) of Regulation S-K (which represent the scaled disclosure requirements).

The SEC notes that pursuant to Item 402(o) of Regulation S-K, smaller reporting companies are required to provide a narrative description of any material factors necessary to an understanding of the information disclosed in the Summary Compensation Table, and if consideration of prior executive compensation advisory votes is such a factor for a particular issuer, disclosure would be required pursuant to the preexisting requirements of Item 402(o).

The proposed rules would require quantification of golden parachute arrangements in merger proxies for smaller reporting companies, even though such issuers are not required to provide this quantification under current Item 402(q) of Regulation S-K in annual meeting proxy statements, and would not be required to do so under the SEC's proposals unless they seek to qualify for the exception for the Say-on-Golden Parachute vote in a later merger or similar transaction.

CONCLUSION

The SEC will need to carefully consider the comments solicited in the Proposing Release before acting on the proposed rules; however, it appears likely that, given the time constraints involved and the relatively prescriptive language of Section 951 of the Dodd-Frank Act, the SEC will adopt final rules that are substantially similar to the proposals.

It appears that based on the current timetable, implementing rules with respect to Say-on-Pay will likely not be effective by the time that September 30 fiscal year-end companies (and many companies with fiscal years ending before December 31, 2010) must file their proxy statements in November and December. The proposed rules and the Proposing Release provide helpful guidance on how the statutory provisions are to be interpreted, as well as useful transition relief. Absent effective rules, the Say-on-Pay vote itself should closely track the resolution as set forth in the statute. With the Say-on-Frequency vote, issuers will have to take the lead of the SEC in its rulemaking, which provides for a resolution that would seek shareholder votes with respect to four choices, one, two, or three years, or abstain, or, in the event that approach is not workable, three options with no exercise of discretionary authority. On the issue of preliminary filing requirements, issuers will not be obligated to file preliminary proxy statements even if rules have not been adopted, in accordance with the relief specified in the Proposing Release.

For calendar year-end issuers, the rules will likely be effective for many of them as they begin filing proxy statements for annual meetings beginning in April 2011. These issuers should continue to monitor the developments with respect to the rule proposal, and use the proposed rules as a guide for drafting 2011 proxy statement disclosures.

Please contact us if you have any questions regarding these rule proposals.

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