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SEC Adopts Rules to Implement Say on Pay

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The Dodd-Frank Act requires (1) a nonbinding shareholder vote on the compensation of a company's named executive officers as disclosed in the proxy statement (Say on Pay Vote), (2) a nonbinding shareholder vote on the frequency of future Say on Pay Votes (Say on Frequency Vote), and (3) disclosure regarding golden parachute arrangements in connection with specified change-in-control transactions and a nonbinding shareholder vote on the golden parachute arrangements.

On January 25, 2011, the Securities and Exchange Commission (SEC) adopted final rules to implement these provisions. The rules regarding the Say on Pay Vote and the Say on Frequency Vote take effect on April 4, 2011. Under the Dodd-Frank Act, the Say on Pay Vote and the Say on Frequency Vote requirements automatically took effect on January 21, 2011, in advance of the final SEC rules. Any shareholder meetings held after that date need to include nonbinding shareholder votes on those matters even if the proxy statement was filed prior to that date. The rules regarding golden parachute arrangements take effect for filings made on or after April 25, 2011.

Say on Pay Vote

Say on Pay Vote Requirement. Rule 14a-21(a) implements the requirement in the Dodd- Frank Act for a nonbinding vote on executive compensation. The vote must be held at any annual meeting of shareholders at which proxies will be solicited for the election of directors, or at a special meeting of shareholders in lieu of such an annual meeting.

Under Rule 14a-21(a), shareholders will vote on whether to approve the compensation of the issuer's named executive officers, as such compensation is disclosed in Item 402 of Regulation S-K, including the Compensation Discussion and Analysis (CD&A), compensation tables and other narrative disclosures regarding executive compensation. The final rules expressly exclude from the Say on Pay Vote nonemployee director compensation and any disclosure required under Item 402(s) of Regulation S-K of risks arising from a company's employee compensation (unless included in CD&A).

The rule does not require issuers to use any specific language or form of resolution. The SEC did include this nonexclusive example of a resolution that would satisfy the applicable requirements: "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 table and narrative discussion is hereby APPROVED." The SEC rules are flexible enough to allow issuers to use a different form of resolution or proposal, including one that does not specifically mention Item 402 as some issuers may determine that the technical rule reference would not be helpful to shareholders.

Timing for Say on Pay Vote. The Say on Pay Vote must occur at the first meeting subject to the Dodd-Frank requirement held on or after January 21, 2011, and not less frequently than every three calendar years thereafter. The final rules clarify that the required frequency is based on calendar years, so that a Say on Pay Vote held after the third anniversary of the last Say on Pay Vote would still comply with the rule as long as the vote is held during the third calendar year after the prior vote. The Say on Frequency Vote required by the Dodd- Frank Act gives shareholders the right to a nonbinding vote on the frequency of Say on Pay Votes. Because the vote is nonbinding, the Board of Directors makes the final determination of how frequently it will hold Say on Pay Votes.

Proxy Statement Disclosure. A new Item 24 has been added to Schedule 14A, which governs proxy statement disclosure requirements, to address disclosure relating to the Say on Pay Vote. Item 24 requires disclosure in the proxy statement that the issuer is providing a separate vote on executive compensation and to briefly explain the effect of the vote, such as whether the vote is nonbinding. The proxy statement must also disclose the current frequency of Say on Pay Votes for the issuer and to disclose when the next Say on Pay Vote will occur. The final rules clarify that this additional disclosure is not required in a company's first year of conducting Say on Pay and Say on Frequency Votes.

Disclosure in Future CD&As. The SEC amended Item 402(b) of Regulation S-K to require issuers to disclose in the CD&A whether and, if so, how the issuer considered the results of the most recent Say on Pay Vote in determining compensation policies and decisions. Discussion of Say on Pay Votes earlier than the most recent Say on Pay Vote is not mandatory, but should be addressed to the extent that the results of an earlier Say on Pay Vote are material to the compensation policies and decisions discussed in the CD&A. Since smaller reporting companies are not required to provide a CD&A, this requirement will not apply to smaller reporting companies. However, 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, which could include the results of a Say on Pay Vote where applicable.

Say on Frequency Votes

Say on Frequency Vote Requirement. Rule 14a-21(b) implements the requirement in the Dodd-Frank Act for a nonbinding vote on the frequency of Say on Pay Votes. Like Say on Pay, the Say on Frequency Vote must be held at any annual meeting of shareholders at which proxies will be solicited for the election of directors, or at a special meeting of shareholders in lieu of such an annual meeting. The frequency vote must occur at the first such meeting held on or after January 21, 2011, and not less frequently than every six calendar years thereafter. The SEC did not provide a form of resolution for the frequency vote requirement. Unless the SEC staff issues interpretative guidance to the contrary, it does not appear that companies are required to structure the Say on Frequency Vote using a formal "Resolved" clause.

Proxy Statement Disclosure. Item 24 of Schedule 14A requires an issuer to disclose that the issuer is providing a separate vote on the frequency of Say on Pay Votes and to briefly explain the effect of the vote, such as whether the vote is nonbinding. If a board recommendation is included, the proxy statement must clarify that shareholders are voting to approve the actual frequency and not the board's recommendation. Proxy Cards. The SEC amended Rule 14a-4 to permit proxy cards to reflect a choice of 1, 2 or 3 years, or abstain, for the frequency vote. Issuers may vote uninstructed proxy cards in accordance with management's recommendation on the frequency vote only if the issuer (1) includes a recommendation for the frequency of Say on Pay Votes in the proxy statement, (2) permits abstention on the proxy card and (3) includes language regarding how uninstructed shares will be voted in bold on the proxy card.

Form 8-K Disclosure Regarding Results of Frequency Vote. Item 5.07 of Form 8-K currently requires disclosure of the results of a meeting of shareholders within four business days of the date of the meeting. This Form 8-K filing will be required to include the results of any Say on Pay or Say on Frequency Votes held at the meeting.

The final rules require an issuer to file an amendment to the Item 5.07 disclosure of the results of the vote. The amendment must disclose the issuer's determination regarding how frequently it will hold Say on Pay Votes. Given that the vote on frequency is nonbinding, an issuer is not required to adopt the results of the shareholder vote on frequency. The Form 8-K amendment will essentially disclose to shareholders whether or not an issuer is going to follow the results of the shareholder vote. The amendment will be due no later than 150 calendar days after the date of the meeting, but in no event later than 60 days prior to the deadline for submitting shareholder proposals under Rule 14a-8 for the next annual meeting, as disclosed in the issuer's proxy materials for the meeting at which the frequency vote occurred.

Disclosure of Golden Parachute Arrangements

The Dodd-Frank Act requires proxy statements seeking shareholder approval of an acquisition, merger, consolidation or sale of all or substantially all of an issuer's assets to disclose any agreements or understandings with the issuer's named executive officers. In addition, it requires similar disclosure by an acquiring issuer of any agreements or understandings with its named executive officers in transactions in which the acquiring issuer is making a proxy or consent solicitation seeking shareholder approval by its shareholders of an acquisition, merger, consolidation or sale of all or substantially all of an issuer's assets. The SEC adopted Item 402(t) of Regulation S-K to specify the disclosure requirements to satisfy this requirement. The disclosure must include both a table and accompanying narrative disclosure. The rules regarding golden parachute arrangements take effect for filings made on or after April 25, 2011.

Tabular Disclosure. The table required by Item 402(t) should be entitled "Golden Parachute Compensation" and present quantitative disclosure of the individual elements of compensation that a named executive officer would receive based on or otherwise relating to the transaction, and the total for each named executive officer. The elements include cash severance payments, dollar value of equity compensation, pension and nonqualified deferred compensation enhancements, tax reimbursements and other compensation. Footnotes must identify each separate form of compensation included in a column as well as whether the benefits are attributable to "single-trigger" arrangements or "double-trigger" arrangements. The final rules allow some flexibility to add additional rows or columns to the table, so long as the disclosure is not misleading.

Narrative Disclosure. The narrative disclosure accompanying the table would include a description of material conditions or obligations applicable to receipt of the benefits, the specific circumstances that would trigger payment, whether the payments would or could be lump sum or their duration, who would provide the payments, and any other material factors.

Compensation Covered. Although the Dodd-Frank Act only requires disclosure of golden parachute compensation arrangements between the target company and its named executive officers, the SEC's final rules also include arrangements between the acquiring issuer and the target's named executive officers. Separate tables will be required where both the target company and the acquiring issuer have such compensation arrangements with the target's named executive officers.

Excluded Items. Item 402(t) does not require disclosure or quantification of previously vested equity awards because these award amounts are vested without regard to the transaction. Similarly, it does not require tabular disclosure and quantification of compensation from bona fide post-transaction employment agreements to be entered into in connection with the merger or acquisition transaction.

Valuation of Equity Compensation. When the tabular disclosure is included in a transaction filing, the dollar value of equity compensation is calculated based on (1) the consideration per share in the transaction if it is a fixed dollar amount or (2) the average closing price per share over the first five business days following the first public announcement of the transaction. If the table is voluntarily included in an annual meeting proxy statement (see below), the value is based on the closing stock price as of the last trading day of the fiscal year.

Individuals Subject to Item 402(t) Disclosure. The disclosure requirements cover the named executive officers of the target company based on the most recent SEC filing that included executive compensation disclosure. Disclosure is not required for persons who are named executive officers because they would have been among the most highly compensated executive officers but for the fact that they were not serving as an executive officer at the end of the last completed fiscal year. However, disclosure is required for individuals treated as named executive officers because they served as principal executive officer or principal financial officer during the last completed fiscal year.

Disclosure in Annual Meeting Proxy Statements. Item 402(t) disclosure on golden parachute arrangements is not required in annual meeting proxy statements. Item 402(j) currently requires disclosure regarding post-employment compensation arrangements, including golden parachute arrangements, but with different, mostly less stringent requirements.

The Dodd-Frank Act does provide an exception from the separate shareholder

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vote on golden parachute arrangements in a merger proxy statement if disclosure of that compensation had been included in the executive compensation disclosure that was subject to a prior Say on Pay Vote in an annual meeting proxy statement.

To qualify for this exception, full disclosure of golden parachute arrangements under Item 402(t) must be included in the annual meeting proxy statement. The less stringent disclosure that issuers currently provide under Item 402(j) will not suffice for this purpose. The exception will be available only to the extent the same golden parachute arrangements previously subject to an annual meeting Say on Pay Vote remain in effect, and the terms of those arrangements have not been modified subsequent to the Say on Pay Vote. If the disclosure pursuant to Item 402(t) has been updated to change only the value of the items in the table to reflect price movements in the issuer's securities, no new golden parachute vote will be required. New golden parachute arrangements, and any revisions to golden parachute arrangements that were subject to a prior Say on Pay Vote, would be subject to the separate merger proxy shareholder vote requirement. Changes that result in a reduction in golden parachute compensation will not require a new vote. Generally, any other change in golden parachute compensation, including new grants of equity compensation in the ordinary course, will trigger a new golden parachute compensation vote.

Disclosure in Other Documents. In addition to a target company's proxy statement to approve a merger or similar transaction, Item 402(t) disclosure is also required in the following documents: (1) an information statement filed pursuant to Regulation 14C with respect to a merger or similar transaction, (2) a target company's Schedule 14D-9 for a tender offer, (3) a registration statement on Form S-4 relating to mergers or similar transactions, (4) going private transactions on Schedule 13E-3 and (5) proxy or consent solicitations that do not contain merger proposals but require disclosure information under Item 14 of Schedule 14A.

Golden Parachute Vote Requirement

Under Rule 14a-21(c), issuers will be required to provide a separate shareholder advisory vote on golden parachute arrangements in proxy statements for meetings at which shareholders are asked to approve an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all assets. This advisory vote will be required only with respect to the golden parachute agreements or understandings required to be disclosed by the Dodd-

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Frank Act. When a target issuer conducts a proxy or consent solicitation to approve a merger or similar transaction, golden parachute compensation agreements or understandings between the acquiring issuer and the named executive officers of the target issuer are not within the scope of disclosure required by the Dodd- Frank Act, and thus a shareholder vote to approve arrangements between the soliciting target issuer's named executive officers and the acquiring issuer is not required.

Smaller Reporting Companies

Although the Dodd-Frank Act authorized the SEC to exempt issuers from the Say on Pay Vote and to take into account whether the Say on Pay Vote would disproportionately burden small issuers in connection with exemptions, the SEC determined that smaller reporting companies should be subject to the Say on Pay Vote. The SEC did adopt a temporary exemption for smaller reporting companies so that these companies 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. The final rules did not directly address what happens if a smaller reporting company transitions from smaller reporting company status before January 21, 2013, but it would seem that such an issuer would need to comply with the Say on Pay Vote and Say on Frequency Votes for any meeting held at a time when the issuer has ceased to be a smaller reporting company.

For smaller reporting companies once they are subject to Say on Pay, shareholders would vote to approve the compensation of the named executive officers required to be disclosed pursuant to the rules applicable to smaller reporting companies, which, among other things, do not include a CD&A. The final rules include an instruction specifying that the Say on Pay Vote does not change the scaled disclosure requirements for smaller reporting companies and that smaller reporting companies are not required to provide a CD&A to comply with the rule.

There is no delay in the applicability to smaller reporting companies of the golden parachute disclosure or vote requirements, so those provisions will apply to smaller reporting companies for filings on or after April 25, 2011.

Amendment to Shareholder Proposal Rule

The final rules amend Rule 14a-8 under the Exchange Act, which governs shareholder proposals, to permit issuers, under certain circumstances, to exclude shareholder proposals that seek to vote on the same matters as the advisory votes on Say on Pay and Say on Frequency required by the Dodd-Frank Act.

To exclude such shareholder proposals, the most recent shareholder vote on frequency must have resulted in a single frequency (1, 2 or 3 years) receiving the support of a majority of the votes cast (rather than a plurality as in the proposed rules) and the issuer must have adopted a policy on frequency of Say on Pay Votes that is consistent with that choice. For this purpose, an abstention will not count as a vote cast.

The exclusion covers shareholder proposals on frequency of Say on Pay Votes as well as shareholder proposals on executive compensation with substantially the same scope as the Say on Pay Vote required by Rule 14a-21(a) – the approval of executive compensation as disclosed pursuant to Item 402 of Regulation S-K.

No Preliminary Proxy Statement Filing Required

Rule 14a-6(a) requires the filing of a preliminary proxy statement with the SEC at least ten calendar days before the date that the definitive proxy statement is first mailed to shareholders. The rule currently has an exception to the requirement to file a preliminary proxy statement if the only matters to be acted upon are any one or more of the following: (1) the election of directors, (2) the election, approval or ratification of accountants, (3) a shareholder proposal under Rule 14a-8, or (4) the approval or ratification of a compensation plan.

With the final Say on Pay rules, the SEC adopted an amendment to Rule 14a-6(a) to add any shareholder advisory votes to approve executive compensation and the frequency of shareholder votes on executive compensation to the list of items that do not trigger a preliminary filing.

Executive Compensation Votes by TARP Recipients

Since recipients of financial assistance under the Troubled Asset Relief Program (TARP) are already required to conduct separate annual votes to approve executive compensation during the period in which any obligations under TARP remain outstanding, the final rules exempt an issuer with outstanding obligations under TARP from the requirements of the Say on Pay Vote and the frequency vote until the issuer has repaid all such obligations. Both votes must be conducted for the first applicable shareholders' meeting occurring after the issuer has repaid all outstanding obligations under TARP.

Transition Matters

As the advisory shareholder votes for Say on Pay and frequency took effect on January 21, 2011, but the SEC's rules covering those matters will not be effective until April 4, 2011, the SEC provided some transitional guidance for issuers. Pursuant to this guidance, until the final rules are effective:

- there is no requirement to file proxy material in preliminary form if the only matters that would require a filing in preliminary form are the Say on Pay and Say on Frequency Votes;
- for all meetings held prior to December 31, 2011, the proxy card for the frequency vote can provide shareholders with three choices (1, 2 or 3 years), and no abstain choice, as long as there is no authority for the issuer to vote uninstructed proxy cards for the frequency vote;
- an issuer with outstanding indebtedness under the TARP does not need to include a resolution for a frequency vote in its proxy statement for its annual meeting, provided it fully complies with its Say on Pay voting obligations under TARP; and
- a smaller reporting company does not need to include a Say on Pay Vote or Say on Frequency Vote in its proxy statement for its annual meeting.