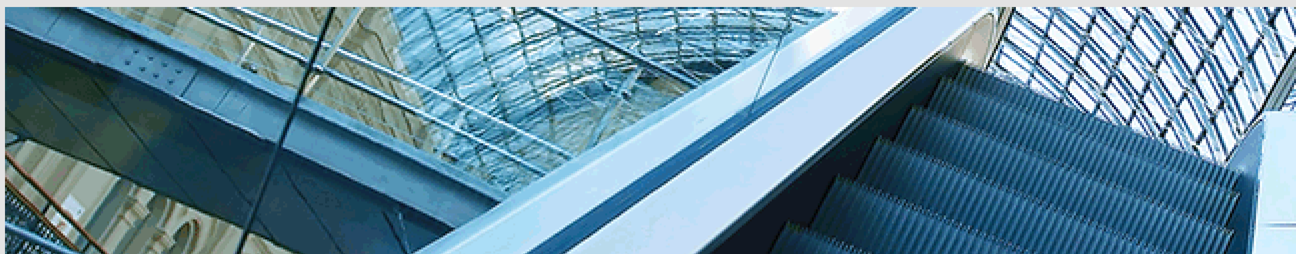

Securities Alert

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SEC Adopts Final say-on-pay Rules

Advisory Votes on Executive Compensation, "Golden Parachute" Compensation, and Frequency of the Executive Compensation Vote

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The Securities and Exchange Commission (SEC) has adopted final rules regarding shareholder advisory votes on executive compensation and "golden parachute" compensation arrangements,[1] implementing certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). The SEC proposed these rules on October 18, 2010[2] and adopted them substantially as proposed, with some modifications and clarifications.

New Section 14A of the Securities Exchange Act of 1934, as amended (the Exchange Act), added by Section 951 of the Dodd-Frank Act, requires public companies to conduct a nonbinding shareholder advisory vote to approve the compensation of a company's named executive officers disclosed pursuant to Item 402 of Regulation S-K under the Securities Act of 1933, as amended (a so-called "say-on-pay" vote), and a separate nonbinding shareholder advisory vote to determine how often a company will conduct the shareholder vote on executive compensation (a so-called "say-on-frequency" vote).

These votes are required to be included in a proxy statement for a company's first annual meeting or other meeting of shareholders at which directors are to be elected, taking place on or after January 21, 2011.

Section 14A also requires public companies to provide disclosure regarding certain so-called "golden parachute" compensation arrangements, as described in further detail below, when engaged in mergers or similar transactions and, in most circumstances, to conduct a separate, nonbinding shareholder advisory vote to approve the golden parachute compensation arrangements.

Unlike the say-on-pay and say-on-frequency votes that are automatically effective on January 21, 2011 under the Dodd-Frank Act, companies are not required to solicit shareholder votes on golden parachute compensation arrangements and include disclosures regarding golden parachute compensation in applicable filings until April 25, 2011. The final rules take effect on April 4, 2011.

The most significant differences between the final rules and the proposed rules are as follows:

- Smaller reporting companies are not required to include say-on-pay and say-on-frequency votes in proxy statements for annual or other meetings at which directors are to be elected taking place prior to January 21, 2013. This temporary exemption does not apply to the votes on or disclosures regarding golden parachute compensation arrangements.
- The determination as to how frequently a company will provide a say-on-pay

vote, in light of the results of the most recent say-on-frequency vote, is required to be included in a Form 8-K or an amendment thereto filed within 150 days after an annual or other meeting at which the say-on-frequency vote was taken, but at least 60 days before the deadline for submitting shareholder proposals for the company's next annual meeting. The rules as proposed would have required this disclosure to be included in a Form 10-Q or Form 10-K covering the reporting period during which the say-on-frequency vote was taken.

- In order for a company to exclude from its proxy statement a shareholder proposal on say-on-frequency or say-on-pay as "substantially implemented" in accordance with Rule 14a-8, a company is required to have adopted a frequency choice that received a *majority* of the votes cast when its most recent say-on-frequency vote was conducted, not a *plurality* of the votes cast as proposed.

say-on-pay Vote

Rule 14a-21(a) under the Exchange Act requires a public company to include in its proxy statement for an annual meeting at which proxies will be solicited for the election of directors, or a special meeting in lieu of such annual meeting, a shareholder advisory vote to approve the compensation of its named executive officers, at least once every three calendar years. This say-on-pay shareholder advisory vote will not be binding on a company or its board of directors.

The SEC did not prescribe specific language or a particular form of resolution to be used for this vote, but provided the following non-exclusive example of a resolution that would satisfy Rule 14a-21(a):

> "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."

The compensation of named executive officers to be voted on by the shareholders is the compensation companies are required to disclose pursuant to Item 402 of Regulation S-K, which is comprised of the Compensation Discussion and Analysis (CD&A) section, compensation tables, and other narrative executive compensation disclosures. Director compensation, reported under Items 402(k) and 402(r) of Regulation S-K, will not be subject to the shareholder advisory vote. In addition, disclosure pursuant to Item 402(s), about a company's compensation policies and practices as they relate to risk management and risk-taking incentives, will not be subject to the shareholder advisory vote because such disclosure relates to compensation of all employees, not just named executive officers. However, to the extent a company's CD&A addresses such risk-related policies and practices, shareholders could consider such matters in casting their say-on-pay votes. The SEC noted that a company may choose to solicit additional shareholder votes on a range of compensation matters to obtain more specific feedback on the company's compensation policies and programs.

say-on-frequency Vote

Rule 14a-21(b) under the Exchange Act will require a company to include in its proxy statement for an annual meeting at which proxies will be solicited for the election of directors, or a special meeting in lieu of such annual meeting, a separate shareholder advisory vote to approve the *frequency* of the say-on-pay votes described above. This vote as to the frequency of the say-on-pay vote must be conducted at least once every six calendar years.

The say-on-frequency shareholder advisory vote will determine whether the say-on-pay vote will be taken every year, every other year, or every three years, and will also not be binding on a company or its board of directors. Under this rule, a company will be required to include the following four choices on its proxy card for the say-on-frequency vote: "one year," "two years," "three years," and "abstain."

The SEC expects a company's board of directors to include a recommendation to shareholders as to its

views on how frequently the vote should occur, but the proxy materials must make it clear that the shareholders are voting on the four choices described above and not on the approval or disapproval of the board's recommendation.

The SEC noted in the final rules that a company may vote uninstructed proxy cards in accordance with management's recommendation for the say-on-frequency vote only if it follows the existing requirements of Rule 14a-4 under the Exchange Act to (1) include a recommendation for the say-on-frequency vote in the proxy statement, (2) permit abstention on the proxy card, and (3) include language regarding how uninstructed shares will be voted in bold on the proxy card.

Amendment to Schedule 14A: New Item 24A

New Item 24A of Schedule 14A requires a company to disclose that a say-on-pay and/or say-on-frequency vote is being taken by the shareholders and to describe the general effect of such votes, including disclosure of the nonbinding nature of the votes. Companies are not required to state in advance what action they plan to take in response to a say-on-pay vote.

After the first say-on-frequency vote, including in any year in which a say-on-frequency vote is not required, a company will be required to disclose in its proxy statement the current frequency of the say-on-pay vote and when the next say-on-pay vote will occur.

For example, a company that first includes a say-on-frequency vote in its proxy statement for the 2011 annual meeting of shareholders would be required to include this new disclosure about the current frequency of its say-on-pay vote in its proxy statement for the 2012 annual meeting of shareholders.

Amendment to CD&A Disclosure

Item 402(b) of Regulation S-K has been amended to require a company to address in its CD&A whether, and if so, how, its compensation policies and decisions have been revised to take into account the results of the most recent say-on-pay vote. This disclosure is a mandatory topic to be discussed in the CD&A.

A company that first includes a say-on-pay vote in its proxy statement for the 2011 annual meeting of shareholders would be required to include this new CD&A disclosure in its proxy statement for the 2012 annual meeting of shareholders. A company may also address its consideration of earlier say-on-pay votes, to the extent such consideration is material to the compensation policies and decisions discussed.

Amendment to Rule 14a-6: No Preliminary Proxy Statement Filing Required for say-on-pay and say-on-frequency Votes

Rule 14a-6 under the Exchange Act has been amended to add say-on-pay and say-on-frequency votes required by Section 14A(a) of the Exchange Act, as well as other advisory votes on executive compensation, to the list of items that do not trigger the filing of a preliminary proxy statement.

Amendment to Form 8-K

Item 5.07 of Form 8-K has been amended to require a company to disclose its decision regarding how frequently it will conduct say-on-pay votes following each say-on-frequency vote. A company is already required to report the results of each vote taken at a meeting of shareholders under Item 5.07 of Form 8-K.

Under amended Item 5.07, a company must file an amendment to its prior Form 8-K, reporting the results of the say-on-frequency vote, to report its determination regarding the frequency of say-on-pay votes no later than 150 calendar days after the date of the annual meeting or other meeting at which the say-on-frequency vote was taken, but in no event later than 60 days prior to the deadline for the submission of shareholder proposals, under Rule 14a-8 under the Exchange Act, for the subsequent annual meeting.

The SEC noted that the change to provide for disclosure in Form 8-K in the final rules is designed to allow more time for companies to consider, through board and committee discussions and discussions with shareholders, how frequently say-on-pay votes will be taken in light of the results of the say-on-frequency vote and other considerations.[3] The rules as proposed would have required companies to disclose this information in a Form 10-Q or Form 10-K for the reporting period in which the vote occurred.

Amendment to Rule 14a-8: Exclusion of Particular Shareholder Proposals

Rule 14a-8 under the Exchange Act has been amended to add a note to Rule 14a-8(i)(10), clarifying that a company will be permitted to exclude a shareholder proposal that seeks an advisory vote on executive compensation or that relates to the frequency of shareholder votes on executive compensation from its proxy statement, as having been already "substantially implemented" if the company has adopted a policy on the frequency of say-on-pay votes that is consistent with the *majority* of the votes cast in the most recent say-on-frequency vote.

For purposes of this analysis, an abstention would not count as a vote cast. The majority standard is a change from the plurality standard, included in the proposed rules, and substantially restricts a company's ability to exclude say-on-pay and say-on-frequency shareholder proposals from its proxy statement, as having been "substantially implemented." In light of having three substantive frequency choices on the proxy card, it is likely that a single choice may not receive a majority of the votes cast at many shareholder meetings.

Say-on-Golden-Parachutes

Vote Requirement

Rule 14a-21(c) under the Exchange Act will require a company to include in its proxy statement for a meeting at which shareholders are asked to approve an acquisition, merger, consolidation, or proposed sale of all or substantially all assets of the company, a separate shareholder advisory vote to approve any golden parachute compensation arrangements that are disclosed pursuant to Item 402(t) of Regulation S-K between the soliciting company and its named executive officers or the named executive officers of the acquiring company, if the soliciting company is not the acquiring company.

Golden parachute compensation is compensation that would become payable to a named executive officer that is based on, or otherwise related to, a merger or similar transaction, including severance payments, payments for the acceleration of options or other equity compensation grants, perquisites, and any other elements of compensation as described further below.

Compensation arrangements between the acquiring company and the named executive officers of the target company will require disclosure under Item 402(t), but will not be subject to the shareholder advisory vote. This "say-on-golden-parachutes" shareholder advisory vote is also not binding on a company or its board of directors. The SEC did not prescribe specific language or a particular form of resolution to be used for this vote.

In accordance with Section 14A(b)(2) of the Exchange Act, a company will not be required to include in its proxy statement for a merger or similar transaction a separate shareholder vote on golden parachute compensation if disclosure of the same golden parachute arrangements, pursuant to Item 402(t), had been included in the executive compensation disclosure that was subject to a prior vote of shareholders under Section 14A(a)(1) of the Exchange Act and Rule 14a-21(a).

If the golden parachute arrangements subject to a prior shareholder vote have been modified since they were subject to a shareholder vote, only the new arrangements and revised terms of the arrangements will be subject to a separate shareholder vote in the proxy statement for a merger or similar transaction under Section 14A(b)(2) of the Exchange Act and Rule 14a-21(c). A grant of new equity compensation awards will be considered a modification of the golden parachute compensation under the rules.

Changes that result only in a reduction in value of the total compensation payable will not require a new shareholder vote. Because changes to executive officer compensation arrangements are likely to occur between the time of an annual meeting and a potential transaction, we expect that only a limited number of companies will be including the disclosure required by Item 402(t) of Regulation S-K in their proxy statements for annual meetings of shareholders, and we have not seen any companies include this disclosure to date in proxy statements filed with the SEC.

In addition, when a company provides for a vote on revisions to or on additional golden parachute compensation arrangements because a merger or sale transaction is taking place, the company would be required to include two tables in its merger proxy statement under Item 402(t): one table for all golden parachute compensation that had previously been disclosed in the prior say-on-pay vote plus all new or revised arrangements, and a second table solely for the new and revised arrangements that are subject to the vote in the merger proxy statement.

Disclosure: Item 402(t) of Regulation S-K

In accordance with new Section 14A(b)(1) of the Exchange Act, the SEC has amended Schedule 14A to require additional, clear disclosure regarding golden parachute compensation arrangements. This requirement, under Item 402(t) of Regulation S-K, will apply to proxy or consent solicitations seeking shareholder approval of an acquisition, merger, consolidation, or proposed sale or disposition of all, or substantially all of, a company's assets, as well as to other disclosure forms used in mergers or similar transactions, such as Form S-4, Schedule 14D-9, Schedule 13E-3, and Schedule TO. Item 402(t) disclosure will not be required in third-party bidders' tender offer statements, so long as the transactions subject to such statements are not also going-private transactions.

Item 402(t) requires, in both tabular and narrative formats, disclosure of agreements or understandings, with respect to golden parachute executive compensation arrangements between each named executive officer of the target company, on the one hand; and either the acquiring company or the target company, on the other hand, related to the transaction being disclosed. Item 402(t) requires that the following table be included in the disclosure document relating to the transaction:

Golden Parachute Compensation

Name (a)	Cash ($)(b)	Equity ($)(c)	Pension/ NQDC* ($)(d)	Perquisites/ Benefits ($)(e)	Tax Reimburse-ment ($)(f)	Other ($)(g)	Total ($)(h)
PEO							
PFO							
A							
B							
C							

* Nonqualified deferred compensation

The table must present quantitative disclosure of the individual elements of compensation that an executive would receive that are based on, or are otherwise related to, the merger or similar transaction, and the total amount payable to each named executive officer. The following elements must be separately quantified and included in the total:

- Any cash severance payment, such as base salary, bonus, and nonequity incentive plan compensation payments (column (b));

- 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 (column (c));
- Pension and nonqualified deferred compensation benefit enhancements (column (d));
- Perquisites, other personal benefits, and health and welfare benefits, without a *de minimis* exclusion, and including information regarding group life, health, hospitalization, or medical reimbursement plans, even if they do not discriminate in scope, terms, or operation in favor of executive officers of the company and are generally available to all salaried employees (column (e));
- Tax reimbursements, such as Internal Revenue Code Section 280G tax gross-ups (column (f)); and
- Any additional, "other" elements of compensation not specifically includable in the other columns of the table (column (g)).

A company is allowed to add additional executive officers or columns to the table. The table requires footnote identification of each separate form of compensation reported and amounts attributable to "single-trigger" arrangements (triggered upon consummation of the transaction) and to "double-trigger" arrangements (triggered only after the occurrence of a termination following the consummation of the transaction).

The quantification applies only to incremental amounts of compensation that are based on, or otherwise related to, the subject merger or similar transaction; and therefore, the table would not include vested equity awards and amounts set forth in the Pension Benefits and Nonqualified Deferred Compensation tables. In addition, bona fide employment agreements to be entered into in connection with the merger or similar transaction and effective on or after the date the transaction is consummated are not required to be disclosed or quantified under Item 402(t). Disclosure of an estimated range of payments is not permitted.

Following the table, narrative disclosure is required to describe the specific circumstances triggering each payment, who would make the payment, whether the payment will be made in installments, material conditions or obligations applicable to each payment, duration of such conditions or obligations, and provisions related to waiver or breach of such conditions or obligations, including, but not limited to, noncompete, nonsolicitation, nondisparagement, or confidentiality agreements, similar to the narrative required currently under Item 402(j) of Regulation S-K with respect to termination and change in control arrangements.

In a proxy statement soliciting shareholder approval of a merger or similar transaction, the tabular quantification of dollar amounts, based on a company's stock price, required by Item 402(t) must be based on the transaction consideration per share, if such value is a fixed dollar amount, or otherwise based on the average closing price per share over the first five business days following the first public announcement of the transaction.

Where Item 402(t) disclosure is included in an annual meeting proxy statement, such amounts must be calculated based on the closing market price per share of the company's securities on the last business day of its last completed fiscal year.

Companies are not required to provide disclosures under Item 402(t) in annual meeting proxy statements, but are allowed to do so if they so choose. This additional disclosure is also required of smaller reporting companies, in connection with any votes to approve any golden parachute compensation arrangements, whether such votes are contained in annual meeting or merger proxy statements. However, the SEC adopted an exception to the disclosure obligations under Item 402(t), with respect to agreements and understandings with senior management of foreign private issuers,

where the target or acquirer is a foreign private issuer.

Timing and Transition

Companies are required to include a say-on-pay shareholder advisory vote and a say-on-frequency shareholder advisory vote in both their preliminary and definitive proxy statements for their first annual meeting or other meetings of shareholders taking place on or after January 21, 2011 (six months following the enactment of the Dodd-Frank Act).

Therefore, companies should promptly begin to consider revisions to their proxy statement disclosure in connection with the newly required votes. The final rules with respect to the implementation do not go into effect until April 4, 2011. Nevertheless, as with the proposed rules, we expect most public companies will follow the final rules prior to their effective date.

Unlike the inclusion of say-on-pay and say-on-frequency votes, the shareholder advisory vote to approve golden parachute compensation arrangements and related disclosure regarding golden parachute compensation arrangements, under Item 402(t) of Regulation S-K, is not required to be included in merger proxy statements and other applicable SEC filings until April 25, 2011.

Smaller reporting companies have a temporary exemption from including say-on-pay and say-on-frequency votes in their proxy statements for shareholder meetings taking place prior to January 21, 2013.

The SEC adopted this exemption to allow smaller reporting companies to observe how the rules operate for other companies and better prepare for the implementation of the rules, as well as to allow the SEC additional time to consider whether adjustments to the rules would be appropriate for smaller reporting companies before such companies are required to comply with the rules.

This exemption applies to newly public companies that qualify as smaller reporting companies, but not to other newly public companies that would be required to include a say-on-pay vote and a say-on-frequency vote in the proxy statement for their first annual meetings after their initial public offerings. The exemption does not apply to disclosures of and votes on golden parachute compensation arrangements.

Companies that are required to hold an annual say-on-pay vote because they have received financial assistance under the Troubled Asset Relief Program (TARP) would not be required to include say-on-pay and say-on-frequency votes in their proxy statements until they have repaid all of their TARP indebtedness and are no longer subject to the annual say-on-pay vote requirement under TARP.

Because say-on-pay and say-on frequency have been implemented by many companies prior to the effective date of the final rules, the SEC has stated the following:

- It will not object if companies do not file preliminary proxy statements with respect to say-on-pay votes and say-on-frequency votes;
- It will not object to smaller reporting companies not including say-on-pay and say-on-frequency votes in their proxy statements; and
- For meetings held prior to December 31, 2011, while proxy service providers are reprogramming their systems to permit shareholders to select among the four choices on the proxy card for the say-on-frequency votes, it will not object if shareholders are only offered the choice of holding the say-on-pay vote every year, every two years, or every three years, and if no choice is selected by a shareholder, the proxy will not be voted.

Broker Discretionary Voting

As prescribed by Section 957 of the Dodd-Frank Act, in September 2010 the SEC approved rules prohibiting brokers who hold securities on behalf of their clients to vote shares for which they have not

received instructions from their clients on say-on-pay proposals and say-on-frequency proposals.

What Steps Should Companies Take Now?

In light of the advent of the say-on-pay regime, companies should consider taking the following steps in order to ease the transition to the new rules.

1. **Evaluate pay packages and practices to determine areas of potential vulnerability.** The Council of Institutional Investors and Institutional Shareholder Services (ISS)/RiskMetrics have each prepared lists of "red flags" to watch for when voting on compensation, including single-trigger severance arrangements, tax gross-ups, absence of stock ownership guidelines, and absence of clawback policies. Companies should consider whether any executive compensation arrangements that may cause controversy are justified in light of the potential for negative scrutiny.
2. **Decide how frequently to recommend shareholders vote on compensation**. ISS recommends that say-on-pay votes be held annually. We understand that many institutional shareholders are likely to vote against members of a board of directors if they recommend a say-on-pay vote any less frequently than once per year. This position should be taken into account in deciding what to recommend to shareholders in this year's proxy statement. Making a frequency recommendation is not required, but advisable to enable uninstructed shares to be voted in favor of the recommended frequency.
3. **Consider whether to engage in outreach to shareholders to ascertain investor sentiment regarding pay packages in advance of the say-on-pay vote.** Some companies have begun to engage in proactive outreach to shareholders, in order to determine their level of satisfaction or dissatisfaction with executive compensation practices, and in order to avoid surprises in the context of the say-on-pay vote. If your company does not employ controversial pay packages or has performed well during the past year, this kind of outreach may be unnecessary. Of course, any outreach to investors would need to be done in compliance with Regulation FD.
4. **Revisit CD&A disclosure to ensure that it tells a robust, clear, and compelling story about the rationale for the executive compensation packages in place at your company.** Now more than ever, the CD&A will serve, in addition to a required element of compensation-related disclosure, as an advocacy piece to support the compensation to be voted upon by shareholders. The document should be reviewed to ensure that it is clear, concise, and supportive of the compensation practices of the organization. As part of such review, consider adding an executive summary to the CD&A to highlight key elements of executive compensation and the relationship of executive pay to performance.
5. **Consider hiring a proxy solicitor to help increase the chances of a favorable vote on say-on-pay**. As noted above, brokers will be unable to vote shares held by their customers with regard to any say-on-pay votes if they do not receive instructions from customers as to how they wish their shares to be voted. In light of this fact and the general likelihood that many investors may need additional advocacy in order to vote in favor of executive compensation practices, it may be helpful to retain a proxy soliciting firm in order to maximize your chances of a favorable result.
6. **Review peer recommendations and voting results.** Consider reviewing the recommendations as to frequency of say-on-pay votes being made by other companies in your peer group, as well as voting results obtained by such companies

with respect to their say-on-pay and say-on-frequency votes. Based on the proxy statements filed thus far, a majority of boards of directors have recommended holding tri-annual say-on-pay votes, but early voting results suggest that shareholders may prefer annual say-on-pay votes.

* * *

We will continue to update you as we are apprised of further developments with respect to these new rules. In the meantime, please contact the Mintz Levin attorney who advises you regarding securities compliance matters if you have any questions regarding these rules or related matters.

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Endnotes

1 See Release No. 33-9178 available on the SEC's website at http://sec.gov/rules/final/2011/33-9178.pdf.

2 See Release No. 34-63123 available on the SEC's website at http://sec.gov/rules/proposed/2010/34-63123.pdf and Mintz Levin client alert on the proposed rules available at http://www.mintz.com/publications/2411/.

3 The SEC has recently stated that Regulation FD will not prohibit a company or a person acting on its behalf, such as directors, executive officers, and investor relations personnel, from speaking privately with a shareholder or select group of shareholders. However, precautions should be taken to not selectively disclose material, nonpublic information under circumstances in which it is reasonably foreseeable that the shareholder will purchase or sell the company's securities on the basis of that information in violation of Regulation FD.

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