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SEC ADOPTS FINAL SAY-ON-PAY RULES

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The Securities and Exchange Commission (the "SEC") recently adopted final rules implementing the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") relating to shareholder approval of executive compensation and golden parachute compensation.[1] Under the new rules, issuers must provide a shareholder advisory vote to approve their executive compensation, also known as "say-on-pay" (or "SOP"), at least once every three years and a shareholder advisory vote to approve the frequency of SOP votes at least once every six years. Issuers must also provide enhanced disclosure regarding merger-related compensation arrangements, also known as "golden parachutes," and provide a shareholder advisory vote to approve certain golden parachute arrangements in proxy statements related to the approval of mergers. Large public companies are required to comply with the SOP and SOP frequency requirements starting with their first annual shareholder meeting that occurs on or after January 21, 2011.[2] Smaller reporting companies[3] must include an SOP vote and SOP frequency vote in their first annual meeting occurring on or after January 21, 2013. The requirements to disclose and provide a shareholder vote on golden parachute compensation arrangements will apply to all proxy solicitations filed on or after April 25, 2011.

As a result, companies that have not already done so should begin now not only to consider the scope and content of their upcoming SOP proposals and related proxy statement disclosures, but also to analyze whether their compensation plans, practices and disclosures should be modified in order to present their compensation programs in the most favorable light prior to the first – and possibly critical – SOP votes.

To assist our clients and friends of the firm, we have prepared (and will continue to update) a chart summarizing the results of recent SOP and SOP frequency votes, which is available at: http://www.wcsr.com/resources/pdfs/SayOnPay.pdf. The remainder of this client alert summarizes the SEC's new SOP rules.

Background

The Dodd-Frank Act added Section 14A to the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which requires companies to conduct separate non-binding shareholder votes to (1) approve the compensation of executives, as disclosed pursuant to Item 402 of Regulation S-K; and (2) determine how

[1] Shareholder Approval of Executive Compensation and Golden Parachute Compensation, Release No. 33-9178 (January 25, 2011), available at http://www.sec.gov/rules/final/2011/33-9178.pdf.

[2] For TARP issuers, the first SOP vote and SOP frequency vote are not required until the first annual shareholder meeting after the issuer has repaid all outstanding TARP indebtedness.

[3] Generally defined as issuers with a public equity float of less than $75 million as of the last business day of the most recently completed second fiscal quarter. See also the SEC's recently issued Compliance and Disclosure Interpretations ("C&DI") on Rule 14a-21 (February 11, 2011), available at http://www.sec.gov/divisions/corpfin/guidance/exchangeactrules-interps.htm#169-01.

often the company will conduct such shareholder advisory votes on executive compensation. In addition, new Section 14A requires companies soliciting votes to approve merger or acquisition transactions to provide disclosure of certain golden parachute compensation arrangements and, in certain circumstances, to conduct a separate non-binding shareholder vote to approve those arrangements. The SEC issued proposed rules to implement Section 14A in October 2010[4] and received over 60 comment letters. The final rules are similar to the proposals, but reflect several changes in response to comments.

Shareholder Advisory Votes on Executive Compensation

Say-on-Pay Vote

The SEC is adopting new Rule 14a-21, which requires issuers,[5] not less frequently than once every three years, to provide a separate shareholder advisory vote in proxy statements to approve the compensation of their named executive officers.[6] The shareholder vote is required only when proxies are solicited for annual or other shareholder meetings for which executive compensation disclosure under applicable SEC rules is required (collectively, "annual meetings"). Shareholders will vote to approve the compensation of the issuer's named executive officers,[7] as such compensation is disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis ("CD&A"), the compensation tables and other narrative compensation disclosures.[8] The final rules do not require any specific language or form of resolution to be voted on by shareholders; however, the SEC has added an instruction to Rule 14a-21(a) indicating that the issuer's resolution should indicate that the shareholder advisory vote is to approve the compensation of the issuer's named executive officers as disclosed pursuant to Item 402 of Regulation S-K.[9] The SEC has also provided the following non-exclusive example of a resolution that would meet the requirements of the rules:

> "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 SEC has also adopted a new Item 24 of Schedule 14A requiring issuers to disclose in the proxy statement that they are providing a separate shareholder vote on executive compensation and to briefly explain the general effect of the vote, such as whether the vote is non-binding.

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[4] Shareholder Approval of Executive Compensation and Golden Parachute Compensation, Release No. 33-9153 (October 18, 2010), available at http://www.sec.gov/rules/proposed/2010/33-9153.pdf. See also our client alert describing the proposed rules, at http://www.wcsr.com/resources/pdfs/cs102710b.pdf.

[5] The new rules apply to all issuers with a class of securities registered under Section 12 of the Exchange Act and subject to the proxy rules.

[6] As defined in Item 402(a)(3) of Regulation S-K.

[7] The compensation of directors is not subject to the shareholder advisory vote. Likewise, the SEC's recently adopted risk management and risk-taking disclosures as they relate to employee compensation policies and practices are not subject to the SOP vote, except to the extent such risk considerations are material to named executive officer compensation and discussed in the CD&A.

[8] Smaller reporting companies will not be required to provide a CD&A in order to comply with Rule 14a-21; however, such companies may include supplemental disclosure to facilitate shareholder understanding of their compensation arrangements in connection with SOP votes.

[9] Last week, the SEC indicated that an issuer may use a plain English equivalent in lieu of the words "pursuant to Item 402 of Regulation S-K." See CD&I 169.05, supra note 3.

Shareholder Advisory Vote on Frequency of Say-on-Pay Vote

In addition to the SOP vote, issuers are now required, not less frequently than once every six calendar years, to provide a separate shareholder advisory vote in annual meeting proxy statements to determine whether the shareholder vote on the compensation of executives discussed above will occur every one, two or three years. The SEC declined to specify a form of resolution for the frequency vote, and recent SEC guidance has indicated that the proposal is not required to be in the form of a "resolution."[10] As with the SOP votes, new Item 24 of Schedule 14A requires disclosure regarding the nature of the shareholder advisory vote on SOP frequency, such as whether the vote is non-binding. Item 24 will also require issuers to disclose the current frequency of SOP votes and when the next scheduled SOP vote will occur.[11]

The SEC has also amended its rules regarding the form of proxy (i.e., the proxy card) to permit proxy cards to reflect the choice of one, two or three years, or abstention, for the SOP frequency votes. In addition, issuers may vote uninstructed proxy cards in accordance with management's recommendation for the SOP frequency vote only if the issuer (1) includes a recommendation for the frequency of SOP votes in the proxy statement, (2) permits abstention on the proxy card and (3) includes bold language regarding how uninstructed shares will be voted on the proxy card.

Disclosure Regarding Say-on-Pay Votes in CD&A

The final rules also amend the SEC proxy rules to require issuers to address in their CD&A whether, and if so, how, they have considered the results of the most recent SOP vote in determining compensation policies and decisions and how that consideration has affected their compensation policies and decisions.[12] Although the requirement only applies to the most recent SOP vote, issuers should address their consideration of previous SOP votes to the extent material to the CD&A.

Preliminary Proxy Statement Not Required

A proxy statement that includes a solicitation with respect to an advisory vote on executive compensation, including an SOP vote or an SOP frequency vote, will not trigger a preliminary proxy statement filing requirement. This rule will apply regardless of whether the advisory vote is required under Section 14A.

Shareholder Proposals Regarding Say-on-Pay

Rule 14a-8 provides eligible shareholders with an opportunity to include a proposal in an issuer's proxy materials for a vote at a shareholder meeting. The issuer may exclude the proposal if it falls within one of the rule's specific bases for exclusion, including an exclusion if the issuer has already "substantially implemented" the proposal. The SEC added a note to Rule 14a-8 to clarify that the "substantially implemented" exclusion would allow an issuer to exclude a shareholder proposal that would provide an SOP vote or seeks future SOP votes or that relates to the frequency of SOP votes, if, in the most recent SOP frequency vote, a single frequency (i.e., one, two or three years) received the support of a majority of the votes cast and the issuer has adopted a policy on the frequency of SOP votes that is consistent with that choice.

[10] See C&DI 169.05, supra note 3.

[11] This requirement was not included in the proposed rules.

[12] Smaller reporting companies are not subject to CD&A requirements; however, if consideration of prior executive compensation advisory votes is a factor necessary to an understanding of the information disclosed in the Summary Compensation Table, disclosure would be required.

Disclosure in Form 8-K

Issuers are currently required to file a Form 8-K report under Item 5.07 disclosing the preliminary results of shareholder votes within four business days after the shareholder meeting and final voting results within four business days after they are known. Item 5.07 will thus require issuers to report how shareholders voted in the SOP and SOP frequency votes. The SEC is now also requiring each issuer to disclose its decision regarding how frequently it will conduct shareholder advisory votes on executive compensation following each SOP frequency vote. This filing will be made as an amendment to the prior Form 8-K filings under Item 5.07 that disclosed SOP and SOP frequency voting results, and it will be due no later than 150 calendar days after the date of the annual meeting, but no later than 60 days prior to the deadline for the submission of shareholder proposals under Rule 14a-8 for the next annual meeting.[13]

Broker Discretionary Vote

As required by the Dodd-Frank Act, the national securities exchanges have begun to amend their rules to prohibit broker discretionary voting of uninstructed shares in certain matters, including shareholder votes on executive compensation. Under these amended exchange rules, for issuers with a class of securities listed on a national securities exchange, broker discretionary voting of uninstructed shares is not permitted for SOP votes and SOP frequency votes.

Disclosure and Shareholder Approval of Golden Parachute Arrangements

Disclosure of Golden Parachute Arrangements

The Dodd-Frank Act amended the Exchange Act to require all persons making a proxy or consent solicitation seeking shareholder approval of an acquisition, merger, consolidation or proposed sale or disposition of substantially all of an issuer's assets ("mergers") to disclose any agreements or understandings that the soliciting person has with its named executive officers (or that it has with the named executive officers of the acquiring issuer) concerning compensation that is based on or otherwise relates to the merger. Disclosure is also required of any agreements or understandings that an acquiring issuer has with its named executive officers and that it has with the named executive officers of the target company in transactions in which the acquiring issuer is making a proxy or consent solicitation seeking shareholder approval of such a transaction. Such disclosures must include the aggregate total of all compensation that may be paid to such executive officers.

In order to implement this disclosure requirement, the SEC has amended its proxy rules (by adding new Item 402(t) of Regulation S-K) to require disclosure in tabular and narrative form of golden parachute arrangements relating to each named executive officer of the target and acquiring companies in any proxy statement relating to a merger. The new "Golden Parachute Compensation" table must provide quantitative disclosure of the individual elements of compensation that each named executive officer would receive based on or otherwise related to the merger, including (1) cash severance payments; (2) the dollar value of accelerated stock awards, in-the-money options awards for which vesting would be accelerated and payments in cancellation of stock and option awards; (3) pension and nonqualified deferred compensation benefit enhancements; (4) perquisites[14] and other personal benefits and health and welfare benefits; and (5) tax reimbursements. Issuers must include footnotes quantifying each separate form of compensation included in the total reported in each column and must also identify amounts attributable to "single-trigger" and "double-trigger" arrangements. Disclosure is only required with respect to compensation based on the merger to which

[13] The proposed rules would have required such disclosure to be made on Form 10-Q or Form 10-K reports.

[14] Item 402(t) will not permit exclusion of de minimis perquisites.

the proxy solicitation relates. Issuers must supplement the table with narrative disclosure of any material factors necessary to an understanding of the golden parachute arrangements, including but not limited to specific circumstances that would trigger payment, whether the payments would or could be lump sum or annual (and their duration), by whom the payments would be provided, and any material factors regarding each agreement. Issuers must also describe any material conditions or obligations applicable to the receipt of payment, including non-compete, non-solicitation, non-disparagement or confidentiality agreements, their duration and provisions regarding waiver or breach.

Shareholder Advisory Vote on Golden Parachute Arrangements

The SEC's new rules also require issuers to provide a separate non-binding shareholder vote on certain golden parachute arrangements in merger proxy statements. This advisory vote is only required with respect to the golden parachute agreements or understandings between the soliciting person and any named executive officer of the issuer or any named executive officers of the acquiring issuer, if the soliciting person is not the acquiring issuer. Notably, the new requirement to disclose golden parachutes arrangements under Regulation S-K Item 402(t), described above, is broader than the requirement to provide a shareholder advisory vote, so there may be certain arrangements for which disclosure is required, but a shareholder advisory vote is not.[15] In addition, a separate shareholder advisory vote on golden parachute arrangements will not be required if proxy statement disclosure of those arrangements had been included in the executive compensation disclosure that was subject to a prior SOP vote (regardless of whether the shareholders approved the SOP vote). In order for issuers to take advantage of this exception, the executive compensation disclosure subject to the prior SOP vote must have included Item 402(t) disclosure of the same golden parachute arrangements. Thus, some issuers may voluntarily include Item 402(t) golden parachute disclosure with their other executive compensation disclosure in annual meeting proxy statements seeking an SOP vote so that this exception will be available to the issuer for a potential subsequent merger or acquisition transaction.[16]

Conclusion

As noted above, companies must assess steps that need to be taken in order to comply with the new SOP and disclosure rules since such rules are effective for many issuers' annual shareholder meetings starting in 2011. Such actions include but are not limited to the following:

- Companies should reassess their compensation programs and policies – and related disclosures – to identify potentially problematic pay practices that could impact SOP votes. Companies may need to consider whether certain controversial pay practices (such as perquisites, gross ups, overly generous severance packages and the like) should be modified or eliminated.

[15] For example, when a target issuer conducts a proxy solicitation to approve a merger, the target issuer would not be required to provide a shareholder advisory vote regarding golden parachute arrangements between the acquiring issuer and the named executive officers of the target issuer. However, such arrangements would be required to be disclosed under Regulation S-K Item 402(t).

[16] Note that this exception will only be available to the extent the same golden parachute arrangements previously subject to the SOP vote remain in effect and the terms of such arrangements have not been modified, although changes that result only in a reduction in the value of the total compensation payable should not require a new shareholder vote.

- Likewise, companies with "best practices" pay provisions in place (such as performance-based vesting, clawback policies, hold til retirement or stock ownership guidelines, double trigger change in control provisions, etc.) should be sure that such practices are prominently disclosed in their proxy statements. Companies should also consider the use of an "executive summary" to the CD&A to highlight the key provisions of their executive compensation programs.

- Companies should also review the proxy guidelines of proxy advisory firms and their largest institutional shareholders to see if additional changes to their compensation programs may be appropriate or if communications with these groups may be helpful to explain why the company thinks so-called "questionable" practices are justified.

- In addition, companies will need to review and revise their disclosure controls and procedures so that they are positioned to comply with the SOP rules.

If you have any questions regarding the new SOP rules, please contact Meredith Burbank (http://www.wcsr.com/lawyers/meredith-burbank), the principal drafter of this client alert, or you may contact the Womble Carlyle attorney with whom you usually work or one of our Corporate and Securities attorneys at the following link: http://www.wcsr.com/profSearch?team=corporateandsecurities.