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

The Securities and Exchange Commission has issued proposed rules to implement the advisory "say-on-pay," "say-on-frequency" and "say-on-golden parachute" shareholder votes required by Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act as well as new related disclosure rules and other requirements.

The proposal reaffirms that, as required by the Dodd-Frank Act, companies must include the say-on-pay and say-on-frequency votes in any proxy statements for shareholder meetings taking place on or after January 21, 2011, regardless of whether the SEC's proposed rules are effective by that time. The proposal includes some transition provisions as discussed in more detail below, which generally provide that the SEC would not object if companies comply with certain provisions of the proposed rules ahead of their adoption. In contrast, the Dodd-Frank Act specifically provides that the say-on-golden parachute provisions are to operate through rules to be promulgated by the SEC and as such, those provisions will not apply until the SEC's proposed rules are effective.

The proposed rules generally do not apply to foreign private issuers.

"Say-on-Pay" and "Say-on-Frequency" Requirements

Say-on-Pay Requirements

The SEC proposal would add new Rule 14a-21(a) under the Exchange Act, pursuant to which U.S. public companies would, for the first annual or other meeting of shareholders on or after January 21, 2011, and at least once every three years thereafter, be required to provide their shareholders with an advisory vote on executive compensation. The proposal does not specify the language of the shareholder resolution; however, the vote must relate to all of the compensation required to be disclosed by Item 402 of Regulation S-K with respect to the named executive officers (NEOs), including the Compensation Discussion and Analysis required under Item 402(b) (CD&A), the compensation tables and other narrative executive compensation disclosures. While a company may choose to provide for separate votes on components of the NEO compensation disclosures, the votes, taken together, must cover all of the compensation arrangements mandated by proposed Rule 14a-21(a). Thus, for example, a vote to approve only compensation policies and procedures would be insufficient. The vote would not apply to director compensation or to disclosure regarding the company's compensation policies and practices as they relate to risk management and risk-taking, unless such risk considerations are discussed in the company's CD&A. The results of the say-on-pay vote and any other matters submitted to a vote of shareholders generally must be disclosed on Form 8-K within four business days under existing SEC requirements.

In addition to implementing the say-on-pay vote required by the Dodd-Frank Act, the SEC is also proposing to amend Item 402(b) of Regulation S-K to require companies to address in the CD&A whether, and if so, how, they have considered the results of their past mandatory say-on-pay votes and how that consideration has affected their compensation policies and decisions.

Say-on-Frequency Requirements

Proposed Rule 14a-21(b) would require that companies, for the first annual or other meeting of shareholders on or after January 21, 2011, and at least once every six years thereafter, provide their shareholders with an advisory vote to determine whether the say-on-pay vote would occur every one, two or three years. The SEC proposes to amend Rule 14a-4's proxy card requirements to allow shareholders a choice between one, two or three years for the frequency of the say-on-pay vote and a choice to abstain. The proposing release notes that companies could still recommend a particular frequency for the say-on-pay vote, but would have to clarify that shareholders are not voting to approve or disapprove the company's recommendation.

The SEC also proposes to amend Forms 10-Q and 10-K to require companies to disclose their decisions regarding the frequency of its say-on-pay votes in light of the results of the shareholder vote on that issue that occurs during the period covered by the Form 10-Q or during the fourth quarter, in the case of the Form 10-K.

Proposed Rules Relating to Both Say-on-Pay and Say-on-Frequency

The SEC has interpreted the provisions of the Dodd-Frank Act to require a say-on-pay vote and a say-on-frequency vote only with respect to an annual meeting of shareholders for which proxies will be solicited for the election of directors, or a special meeting in lieu of such annual meeting.

The say-on-pay and say-on-frequency votes would not be binding on a company or its board of directors, could not be construed as overruling any decision of the company or its board and would not change or add to the fiduciary duties of the company or its board. However, the SEC proposes to amend Rule 14a-8(i)(10) to allow the exclusion of shareholder proposals that seek a present or future say-on-pay vote or that relate to the frequency of say-on-pay votes as "substantially implemented" only if the company has adopted a policy on the frequency of say-on-pay votes that is consistent with the plurality of votes cast on that issue in the most recent vote.

The proposed rules would add a new Item 24 of Schedule 14A that requires companies to disclose that they are providing the say-on-pay and say-on-frequency votes, as applicable, and briefly explain the general effect of each vote, such as whether each such vote is non-binding.

Rule 14a-6 would be amended to specify that the addition of the say-on-pay and say-on-frequency votes would not trigger a preliminary filing of proxy materials with the SEC.

The proposing release confirms that broker discretionary voting of uninstructed shares would not be permitted for the say-on-pay and say-on-frequency votes.

Also, because companies with outstanding indebtedness under the Troubled Asset Relief Program are already required to provide an annual say-on-pay vote, they are exempt from the say-on-frequency requirement until such companies have repaid all indebtedness under TARP.

Transition Provisions

Because the say-on-pay and say-on-frequency requirements set forth in the Dodd-Frank Act are effective for shareholder meetings on or after January 21, 2011 (regardless of whether the SEC's proposed rules are effective in time for such implementation), they apply to any proxy statements, whether in preliminary or definitive form, even if filed prior to January 21, 2011. The proposing release therefore sets forth guidance relating to the application of some of the proposed rules before their effective date. Among other things, the proposing release states that the say-on-pay and say-on-frequency votes would not trigger the requirement to file proxy materials in preliminary form with the SEC and that the SEC would not object if companies (i) include a proxy card that offers shareholders the requisite one, two or three year say-on-pay frequency or abstain options, or, if proxy solicitors cannot timely reprogram their systems to accommodate four options, include a proxy card that offers a choice among one, two or three years (provided that the company may not vote proxies where the shareholder has not selected a choice among those three options), and (ii) do not offer its shareholders a say-on-frequency vote or a separate say-on-pay vote under Rule 14a-21 (for companies with outstanding indebtedness under TARP that otherwise fully comply with their say-on-pay voting obligations under the Emergency Economic Stabilization Act of 2008).

"Say-on-Golden Parachute" and Additional Disclosure of Golden Parachute Arrangements

Say-on-Golden Parachute Requirements

Proposed Rule 14a-21(c) would require a company soliciting shareholder approval of an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all of its assets to provide a separate shareholder advisory vote on any written or unwritten agreements or understandings regarding compensation disclosed pursuant to proposed Item 402(t) of Regulation S-K. As discussed below, proposed Item 402(t) would require disclosure of such arrangements or understandings between any NEO of the acquirer or the target, on the one hand, and the acquirer or target, on the other hand, other than agreements or understandings between the acquirer and the NEOs of the target where the target company is making the shareholder solicitation. The proposing release clarifies that this disclosure requirement does not apply to individuals who are treated as NEOs under Item 402(a)(3)(iv) of Regulation S-K 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.

Although the proposing release states that this advisory vote would be required only with respect to the golden parachute agreements or understandings required to be disclosed under

Section 14A(b)(1) of the Dodd-Frank Act, as disclosed pursuant to proposed Item 402(t), we note that Rule 14a-21(c) as proposed would require an advisory vote that covers more golden parachute arrangements than those contemplated by the Dodd-Frank Act itself. For example, where the target is soliciting shareholder approval of an M&A transaction, proposed Rule 14a-21(c) would appear to require not only a vote on golden parachute arrangements between its NEOs and the target or acquirer (as specified by the Dodd-Frank Act), but also a vote on golden parachute arrangements between the acquirer and the acquirer's NEOs.

Companies could alternatively seek approval of such golden parachute arrangements as part of their general say-on-pay vote. However, any changed or new arrangements would need to be approved by shareholders. As an example, the proposing release states that any change that would result in an Internal Revenue Code Section 280G tax gross-up becoming payable would be considered a change in terms requiring an additional advisory vote. The proposing release also states that if the disclosure under Item 402(t) has been updated to change only the value of the items in the tabular disclosure to reflect price movements in the issuer's securities, no new say-on-golden parachute vote would be required. It is unclear whether the SEC would require a new say-on-golden parachute vote if an IRC Section 280G tax gross-up became payable to one or more NEOs solely as a result of an increase in the issuer's stock price (as contrasted with a change in the terms of an existing golden parachute arrangement to add a tax gross-up provision where none previously existed).

As with the say-on-pay and say-on-frequency votes, the say-on-golden parachute vote would not be binding, and the SEC does not prescribe a form of resolution to be used. Similarly, proposed new Item 24 of Schedule 14A would require companies to disclose that they are providing the say-on-golden parachute vote and briefly explain the general effect of the vote, such as whether the vote is non-binding.

Proposed Item 402(t) Disclosure

Proposed new Item 402(t) of Regulation S-K is more expansive than the currently required disclosures on golden parachute arrangements under existing Item 402(j) of Regulation S-K and Item 5 of Schedule 14A (Interest of Certain Persons in Matters to Be Acted Upon). Among other things, new Item 402(t) does not include a *de minimis* exception for perquisites and requires disclosure of all golden parachute arrangements, including those that do not discriminate in favor of executive officers or directors and that are available generally to all salaried employees.

Companies would be required to provide tabular disclosure with respect to each NEO of the acquiring and target companies for which such disclosure is required of any written or unwritten golden parachute arrangements between the NEO and the acquiring or target company, including disclosure of the aggregate dollar value of the following items:

- Cash severance payments, including but not limited to payments of base salary, bonus, and pro-rated non-equity incentive compensation plan payments;
- Stock awards for which vesting would be accelerated; in-the-money option awards for which vesting would be accelerated; and payments in cancellation of stock and option awards;

- Pension and nonqualified deferred compensation benefit enhancements;
- Perquisites and other personal benefits or property, and health care and welfare benefits (including a requirement that the value of health care benefits be determined based on the assumptions used for financial reporting purposes under GAAP);
- Tax reimbursements (such as IRC Section 280G tax gross-ups) ;
- Any other compensation that is based on or otherwise relates to the transaction that is not properly reported in any of the foregoing items; and
- The sum of all such payments.

For all of the foregoing disclosures, companies would have to include footnote disclosure quantifying the amount payable upon the occurrence of the subject transaction (single-trigger arrangements) and those that are contingent on an additional condition, such as termination of employment without cause or resignation for good reason (double-trigger arrangements). For double-trigger arrangements, companies would have to specify the period of time in which such termination or resignation must occur for the amount to become payable. For each category of golden parachute compensation, companies would have to include footnote disclosure quantifying each separate form of compensation included in the totals reported (other than the overall total of golden parachute compensation), such as the identification and quantification of all perquisites and other personal benefits or property as is currently required in the Summary Compensation Table filed in annual proxy statements and Form 10-Ks.

A company that had previously sought approval of golden parachute arrangements at an annual meeting, but which now seeks approval of new or revised arrangements, would be required to provide two separate tables, one that discloses all golden parachute compensation and another that discloses only the new or revised arrangements. Further, if the proposed Item 402(t) disclosure is different from the compensation subject to a say-on-golden parachute vote pursuant to proposed Rule 14a-21(c), the company would have to provide a separate table for those agreements and understandings that are subject to the say-on-golden parachute vote. For example, when disclosure is needed of arrangements between an acquiring company and the NEOs of the soliciting target company, one table must be used to disclose all golden parachute compensation, whether in connection with agreements with the target or the acquiring company, and another table must be used to disclose the compensation in connection with agreements with the target company that is subject to the advisory vote.

Companies must also provide a narrative description of any material factors necessary to an understanding of each arrangement disclosed in the table, including the specific circumstances that would trigger payment, whether the payments would or could be lump sum or annual, the duration of such payments, by whom the payments would be made and any material conditions or obligations applicable to the receipt of such payments (such as non-compete, non-solicitation, non-disparagement or confidentiality agreements; their duration and provisions regarding their waiver or breach).

- The proposing release notes that Item 402(t) would require tabular and narrative disclosure only of compensation that is based on or otherwise relates to the proposed transaction. As such, Item 402(t) would not require separate disclosure or quantification with respect to compensation already disclosed in the Pension Benefits Table and Nonqualified Deferred Compensation Table, previously vested equity awards or bona fide post-transaction employment agreements to be entered into in connection with the transaction (as the SEC states in the proposing release that it does not view such future employment arrangements as compensation "that is based on or otherwise relates to" the transaction). The SEC does note that information regarding such future employment arrangements is disclosable under Item 5(b)(xii) of Schedule 14A and may also be disclosable under Item 5(a) of Schedule 14A, if such arrangements create a "substantial interest" on the part of the NEOs in the transaction.

Finally, the SEC proposes to add the above disclosure requirements to Item 1011(b) of Regulation M-A so that disclosures would be conformed regardless of the particular structure of the proposed transaction. In particular, these disclosure requirements will be added to Schedule 13E-3 (for going-private transactions), Schedule 14A (for proxy solicitations in both contested and uncontested situations), Schedule 14C (for information statements) and Schedule TO and Schedule 14d-9 (for tender offers). For Schedule TO disclosure, third party bidders would be required to make such disclosure only to the extent that such information is known after making reasonable inquiry.

Companion Proposal on Reporting of Proxy Votes on Executive Compensation by Institutional Investment Managers

The SEC issued on the same day a companion release to implement the Dodd-Frank Act requirement that institutional investment managers subject to Section 13(f) of the Exchange Act report their votes on executive compensation and golden parachute arrangements at least annually, unless the votes are otherwise required to be reported publicly by SEC rules. If adopted as proposed, institutional investment managers would be required to file their first reports by August 31, 2011 for the meetings occurring on or after January 21, 2011 and ending on June 30, 2011.

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For a copy of the say-on-pay and say-on-frequency proposal, see http://sec.gov/rules/proposed/2010/33-9153.pdf. For a copy of the proposal on reporting of proxy votes on executive compensation by institutional investment managers, see http://sec.gov/rules/proposed/2010/34-63123.pdf. The SEC is seeking comments on many aspects of these proposed rules and such comments are due November 18, 2010.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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