SEC Adopts "Say on Pay" Rules for Public Companies

On January 25, 2011, the Securities and Exchange Commission adopted by a 3-2 vote final rules on say on pay, say on frequency and say on golden parachutes advisory votes, which give shareholders of public companies a voice on executive compensation and golden parachute arrangements.

The final rules largely track the proposed rules released in October 2010. The most notable differences are:

- **Smaller reporting company reprieve.** Smaller reporting companies (companies with a public float of less than $75 million) have been granted a reprieve from compliance with say on pay and say on frequency rules until their first annual shareholder meeting on or after January 21, 2013. As originally proposed, smaller reporting companies would have been required to comply for annual shareholder meetings held on or after January 21, 2011.
- **Basis for exclusion of shareholder proposal.** A company may exclude a shareholder-initiated proposal on say on pay or say on frequency if the company has adopted the frequency approved by a majority of votes cast by shareholders (a higher threshold than the proposed rules, which would have permitted exclusion of a proposal if the company adopted the frequency chosen by a plurality of votes).
- **Form 8-K reporting of company decision on frequency.** Disclosure of the company's frequency decision will be reported on Form 8-K (rather than in the company's Form 10-Q or Form 10-K covering the period in which the vote was taken, as the proposed rules would have required). The deadline for filing the Form 8-K will be 150 days after the shareholder meeting at which the say on frequency vote was taken or 60 calendar days before the deadline for submission of any shareholder proposals under Rule 14a-8 for the company's next annual meeting, if earlier.

A description of the rules and associated amendments, which may be found at the SEC's web site here, is provided below.

Shareholder Approval of Executive Compensation

A. Say on Pay

New Rule 14a-21(a) of the Exchange Act requires an issuer to include in proxy statements for meetings at which proxies are solicited for the election of directors a separate shareholder advisory vote to approve the compensation of the issuer's named executive officers, as disclosed pursuant to Item 402 of Regulation S-K. Approval of executive compensation is required to be put to a vote of shareholders at least once every three calendar years. Although the rule does not mandate use of a specific resolution[1], a proposal that fails to

[1] An instruction to Rule 14a-21(a) provides a non-exclusive example of a say on pay resolution that would satisfy Rule 14a-21(a), which will likely become the *de facto* standard.

include all executive compensation disclosed pursuant to Item 402 would not be acceptable (for example, a vote to approve compensation policies and procedures, without more, would not suffice).

The new rules amend Item 402(b) of Regulation S-K to require that the Compensation Discussion and Analysis disclose whether (and if so, how) the issuer's compensation policies and decisions have taken into account the results of the most recent say on pay vote. This requirement is for disclosure only and does not mandate that a board make changes in the wake of a vote (negative or positive) on say on pay. However, we expect that proxy advisory groups will be intently focused on whether changes are made, particularly following a significant negative vote.

B. Say on Frequency

Rule 14a-21(b) of the Exchange Act requires issuers, at least once every six calendar years, to include in proxy statements for meetings at which proxies are solicited for the election of directors a separate shareholder advisory vote to determine the frequency of the say on pay vote. The rule requires that shareholders be given four choices: a vote every year, a vote every other year, a vote once every three years or an abstention from the matter. If the board of directors of an issuer chooses to include a recommendation on the frequency of the vote, it must be clear that all four choices are available and that the proposal being voted upon is not one in which shareholders are voting to approve or reject the board's recommendation.

To enable issuers to comply with this rule, the SEC has amended Rule 14a-4, which dictates the form of a proxy card, to accommodate the presentation of the four choices. Because certain proxy service providers may not be able to reprogram their systems to accommodate four choices in the short-term, the SEC will not object if proxy materials filed for shareholder meetings on or before December 31, 2011 only present the choice to vote among one, two or three years as long as management does not retain discretionary authority to vote the shares of a shareholder who does not select any of those three choices.

The SEC has also amended Form 8-K to require an issuer to disclose its decision on how frequently it will conduct the say on pay vote in light of the results of how shareholders voted on this issue. Currently issuers are required to report on Form 8-K the results of all matters submitted to shareholders at any meeting within four business days of the meeting. We expect that some issuers will be able to announce their frequency choice in that Form 8-K, particularly where there is a majority or plurality in favor of the board's recommendation. If the decision is delayed, an issuer will now be required to amend the Form 8-K in which it reported the meeting results to disclose its frequency choice. The amendment will be due within 150 calendar days of the meeting date or 60 calendar days before the deadline for submission of any shareholder proposals under Rule 14a-8 for its next annual meeting, if earlier.

C. Amendments related to both Say on Pay and Say on Frequency

Non-Binding Nature of the Votes and Timing of Say on Pay Votes

The new rules confirm that the say on pay and say on frequency votes required by the Dodd-Frank Act are non-binding on an issuer. New Item 24 of Schedule 14A requires that an issuer (i) disclose that it is providing a separate shareholder vote on executive compensation and on the frequency of the executive compensation vote in proxy statements containing such votes, (ii) briefly explain the general effect of the votes, such as whether the votes are non-binding, and (iii) disclose the current frequency of such issuer's say on pay vote and when the next say on pay vote will be conducted.

Exclusion of Certain Shareholder Proposals Permitted

An amendment to Rule 14a-8(i)(10) allows issuers to exclude a shareholder proposal that would provide a say on pay or say on frequency vote, provided the issuer has adopted a policy on frequency that is consistent with the choice of a majority of votes cast in the most recent say on frequency vote.

Preliminary Proxy Not Required

The SEC has also amended Rule 14a-6 to add shareholder advisory votes on executive compensation (including shareholder votes on say on pay and say on frequency) to the list of matters for which a preliminary proxy statement would not be required, consistent with the transitional guidance given by the SEC in connection with the proposed rules.

D. Say on Golden Parachutes

The say on golden parachutes rule not only requires a shareholder vote on golden parachutes but imposes on issuers significant, new disclosure obligations about these arrangements, which are more expansive than the current disclosure requirements of Item 402(j) of Regulation S-K (relating to potential payments upon termination or a change in control). New Item 402(t) differs from Item 402(j) in that Item 402(t) requires:

- Presentation of an aggregate total of all compensation based on or triggered by a transaction;
- Tabular disclosure;
- Disclosure of arrangements generally available to all salaried employees; and
- Disclosure of de minimis perquisites and other personal benefits.

New Rule 14a-21(c) of the Exchange Act requires issuers, in any proxy or consent solicitation for a meeting at which shareholders are asked to approve an acquisition, merger, consolidation or proposed sale or disposition of all or substantially all of an issuer's assets, to provide a separate shareholder advisory vote to approve the golden parachute payments disclosed under new Item 402(t) of Regulation S-K, described below.

New Item 402(t)

New Item 402(t) of Regulation S-K requires disclosure[2] in both narrative and tabular form of all written and unwritten agreements concerning compensation that is based on or is related to the subject transaction (1) between the target issuer and the named executive officers of the target issuer or (2) between the acquiring company and the named executive officers of the target issuer. The requirement to provide disclosure of agreements with the acquiring company was not included as part of the Dodd-Frank Act.

The narrative disclosure requirements of Item 402(t) require issuers to describe, for each named executive officer of the target company and the acquiring company, the individual elements of compensation that the

[2] The text of the rule expressly requires disclosure in the target's proxy statement of any arrangement by which a named executive officer of the acquiring company is compensated as a result of the transaction. Thus, for example, a completion bonus payable by the acquiring company to its CEO would appear to be picked up.

executive would receive based on or otherwise related to the transaction and the total amount for each named executive officer. Separate quantification in tabular format is required for:

- Cash severance;
- The dollar value of accelerated stock and option awards (including the value attributable to any cash out of the awards);
- Pension and nonqualified deferred compensation enhancements;
- Perquisites (without the $10,000 threshold applied) and other personal benefits and health and welfare benefits;
- Tax reimbursements; and
- Any other compensation not specifically identified.

In addition, the table requires separate footnote identification of amounts attributable to single and double trigger arrangements. Any material conditions or obligations applicable to the receipt of payment (for example, non-compete, non-solicitation or non-disparagement covenants and confidentiality agreements), the duration of those conditions or obligations and the provisions regarding waiver or breach are also required to be disclosed.

No disclosure would be required under Item 402(t) of compensation that would have been vested or earned without regard to the transaction, such as previously vested stock options or pension amounts. In addition, the table does not require disclosure or quantification of compensation from bona fide post-transaction employment agreements to be entered into in connection with the transaction.

If any part of the Item 402(t) disclosure had already been disclosed in an annual meeting proxy statement and been subject to a prior shareholder say on pay vote, then the issuer would not need to include the portion already voted upon in the vote required by Rule 14a-21(c), regardless of whether shareholders had approved the compensation or not. If a portion of the compensation disclosed under Item 402(t) had previously been subject to a say on pay vote, then under Rule 14a-21(c), the issuer would be required to present two tables under Item 402(t), with identical column and row headings. One of the tables would present the previously voted-upon golden parachute compensation. The other table would present only that portion of the golden parachute compensation that had not been subject to prior shareholder approval, and the shareholder advisory vote would only cover the compensation disclosed in this second table. Because dual disclosure provides no practical benefits, it is virtually unthinkable that issuers that have any meaningful golden parachute arrangements would find it useful to present the golden parachute vote at an annual meeting; they will instead include all Item 402(t) disclosure in a merger proxy statement.

Extended Application of Disclosure Requirements

Item 402(t) disclosure will be required to be included in essentially all documents that relate to a business combination, including:

- Information statements filed pursuant to Regulation 14C;

- Proxy or consent solicitations that do not contain merger proposals but require disclosure of information under item 14 of Schedule 14A pursuant to Note A of Schedule 14A (for example, proxies solicited to approve the issuance of new shares or a reverse stock split in order to conduct a merger transaction);

- Registration statements on Forms S-4 and F-4 (that do not otherwise contain certain proxy statement disclosure) containing disclosure relating to mergers and similar transactions;

- Going private transaction statements on Schedule 13E-3; and

- Schedule 14D-9 solicitation/recommendation statements.

Shareholder approval, however, would not be required in connection with these additional disclosure requirements.

E. Companies to Which the New Rules Apply

The new rules apply to all issuers that are subject to the proxy solicitation requirements of the Exchange Act, including all domestic issuers. Foreign private issuers will generally not be subject to the new rules.

F. Effective Date

While the say on pay and say on frequency rules will not technically be effective until 60 days after publication in the Federal Register, implementation by public companies (other than smaller reporting companies) will occur immediately as the Dodd-Frank Act already requires such companies to hold say on pay and say on frequency votes at such companies' first shareholder meetings held on or after January 21, 2011. Smaller reporting companies do not need to comply with the say on pay and say on frequency rules until their first annual shareholder meeting on or after January 21, 2013.

The new disclosure and voting requirements with respect to golden parachutes will be applicable for initial filings of the applicable statements and schedules by issuers (including smaller reporting companies) made on or after April 25, 2011.

If you would like to discuss these or any other securities law matters, please contact any member of Ropes & Gray's Securities & Public Companies practice or Tax & Benefits department or your usual Ropes & Gray advisor.