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October 21, 2010 | Posted By

Time to Get Ready for Say-on-Pay as SEC Releases Proposed Rules

In accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Reform Act") and its own timetable for proposing regulations required by section 951 of the Reform Act, the Securities and Exchange Commission on October 18, 2010 issued a press release and published proposed rules (Release No. 33-9153) (the "Proposed Rules") for shareholder advisory votes on executive compensation ("Say-on-Pay") and golden parachutes. The SEC also concurrently released proposed regulations (Release No. 34-63123) which would require certain institutional investment managers to report annually how they voted on executive compensation matters (we will cover this second set of proposed regulations in a separate blog article).

As we previously commented (see our blog from July 26, 2010 *"The Regulatory March to Reform Executive Compensation Practices Takes Another Step Forward"*), the Reform Act implemented numerous new laws affecting executive compensation and corporate governance at publicly-held companies. Section 951 of the Reform Act requires that publicly held corporations provide their shareholders with the ability to render separate votes to approve: (1) executive compensation, (2) the frequency of shareholder Say-on-Pay votes, and on (3) golden parachute arrangements for the company's named executive officers ("NEOs") in connection with merger/acquisition transactions ("M&A"). The shareholder votes are advisory in effect and are not binding on the company or its board of directors. The Reform Act also gave the SEC the authority to exempt certain companies, such as smaller reporting companies, from Say-on-Pay.

The Proposed Rules provide some interesting details regarding the implementation of Say-on-Pay, including imposing additional disclosure requirements above and beyond what might have been expected. The Proposed Rules also provide guidance for smaller reporting companies and for those companies which are still subject to the requirements of the Troubled Asset Relief Program ("TARP"). Of course, the Proposed Rules are yet not effective and in this regard the SEC has solicited the public for comments in numerous areas of the Proposed Rules in order to help them in their process of adopting final regulations. Below is a brief overview of the Proposed Rules.

SHAREHOLDER ADVISORY SAY-ON-PAY VOTE

Generally

- *What: (Proposed Rule 14a-21(a))*. A separate shareholder advisory vote to approve the compensation of NEOs would need to be provided in a company's proxy statement for annual or other shareholder meetings (and in which executive compensation disclosure is required to be disclosed under Item 402 of Reg. S-K) at least once every three years. The proxy statement's Compensation Discussion and Analysis ("CD&A") section, executive compensation tables and other executive compensation disclosures, including for example disclosed risk considerations related to the compensation policies for NEOs would all be considered to be part of the executive compensation that is subject to the vote. Smaller reporting companies, while required to conduct a Say-on-Pay vote, would continue to not be required to prepare a CD&A. There is no mandated specific resolution language that will be the subject of the shareholder vote but the vote must be to approve the disclosed NEO compensation.

- *When:* A Say-on-Pay vote would be required for a company's first annual or other meeting of shareholders occurring after January 20, 2011.

Required Disclosures

- *What: (Proposed Item 24 to Schedule 14A; Item 402(b) of Reg. S-K)*. Companies would be required to disclose in their proxy statement that they are providing a separate Say-on-Pay vote and to explain the general effect of the vote including whether the vote is non-binding.

  Companies would also need to describe in their CD&A whether and how their compensation policies and decisions have taken into account the results of the Say-on-Pay vote. Smaller reporting companies would be required to include such a disclosure in their proxy statement only if their consideration of Say-on-Pay vote results was a material factor in understanding their Summary Compensation Table information.

SHAREHOLDER ADVISORY VOTE ON FREQUENCY OF SAY ON PAY VOTE

Generally

- *What: (Proposed Rule 14a-21(b))*. Companies would be required, not less frequently than once every six years, to provide a separate shareholder advisory vote in proxy statements for annual or other shareholder meetings (and in which executive compensation is required to be disclosed) on whether the Say-on-Pay vote will occur every 1, 2 or 3 years (the "Frequency Vote"). Proxy statements would

need to provide shareholders with the four alternative choices of selecting 1, 2, or 3 years for the frequency of the Say-on-Pay vote or to abstain. While the company's board of directors may include a recommendation as to which frequency shareholders should vote for, the Frequency Vote is on the preferred frequency itself and is not a vote to approve or disapprove the board's recommendation.

- *When:* A Frequency Vote would be required for a company's first annual or other meeting of shareholders occurring after January 20, 2011.

Required Disclosures

- *What: (Proposed Item 24 to Schedule 14A; Proposed amendments to Rule 14a-4 and Forms 10-Q and 10-K)*. Companies would be required to disclose in the proxy statement that they are providing a separate shareholder vote on the frequency of the Say-on-Pay vote and to explain the general effect of the Frequency Vote including whether the vote is non-binding. In accordance with the existing requirements under Form 8-K, companies will be required to disclose the results of the shareholder votes within four business days of the shareholder meeting. Companies would also be required to disclose in their Form 10-Q (covering the period in which the Frequency Vote occurred) or Form 10-K (if the Frequency Vote occurred in the Company's fourth quarter) its decision on how frequently it will conduct the Say-on-Pay vote in light of the results of the Frequency Vote.

Ability to Exclude Shareholder Proposals related to Say-on-Pay or Frequency Vote

- *What: (Proposed amendment to Rule 14a-8)*. In an interesting development, if a company adopts a frequency for its Say-on-Pay votes that is consistent with the plurality of votes cast in its most recent Frequency Vote, then the company will more easily be able to exclude from its proxy statements shareholder proposals involving shareholder votes on NEO executive compensation or involving the frequency of such a vote. Thus, there is an incentive for companies to adopt a frequency of Say-on-Pay votes that is consistent with the results of the non-binding Frequency Vote.

SHAREHOLDER ADVISORY VOTE ON GOLDEN PARACHUTE ARRANGEMENTS

Generally

- *What: (Proposed Rule 14a-21(c)* and Proposed Amendments to Schedule 14A). A separate shareholder advisory vote on approving NEO golden parachute arrangements would need to be included in M&A or similar transactions proxy solicitations in which shareholders were being asked to approve the company's corporate transaction. However, the advisory vote would only be on the golden parachute arrangements required to be disclosed by the Reform Act with respect to the specific M&A transaction. As noted below, the Proposed Rules would require disclosure of golden

parachute compensation information that extends beyond the requirements of the Reform Act. Such additional disclosures, while required, would not be subject to the shareholder vote unless the company voluntarily decided to subject these additional golden parachute arrangements to the shareholder vote. As with the Say-on-Pay vote, there is no specific resolution language and the shareholder vote is not binding on the company or its directors.

- *When:* The separate shareholder advisory vote on golden parachute compensation arrangements will not be required for M&A proxy solicitations until the effective date of the SEC's final rules.

Required Disclosures – Golden Parachute Compensation Table

- *What: (Proposed Item 402(t) of Reg. S-K).* Golden parachute arrangements for NEOs would need to be described in proxy or consent solicitations issued in connection with M&A or similar transactions. Covered transactions would also include, among other things, going private transactions and third party tender offers. Moreover, bidders in a third party tender offer may also be required to include target company golden parachute arrangement information in its Schedule TO. Foreign private issuers would be exempt from the golden parachute compensation disclosure obligations.

  Companies would be required to disclose in their M&A proxy solicitation in both narrative and tabular form the golden parachute arrangements of the NEOs. The Proposed Rules would mandate using a specific "Golden Parachute Compensation" columnar table with elements that resembles the Summary Compensation Table. The Golden Parachute Compensation table would contain quantitative disclosure of the various elements of all golden parachute compensation (e.g., cash, equity, tax reimbursement, etc) that *"is based on or otherwise relates to"* the specific M&A transaction and these figures would be separately reported for each NEO along with aggregate totals. Items such as previously vested equity or post-transaction employment agreements would not be required to be reported under this disclosure item because such items are not based on or do not otherwise relate to the transaction. Note that the Golden Parachute Compensation table would report on the applicable golden parachute compensation arrangements for the NEOs of *both* the target and *acquiring* company.

  Each entry in the Golden Parachute Compensation table would require footnote identification and discussion of the material elements including payment triggering events and the conditions and form of payment. There would also need to be separate discussion of "single trigger" versus "double trigger" items.

  The SEC also acknowledged that the new required golden parachute compensation disclosures extend beyond what is technically required by the Reform Act. Therefore, the Proposed Rules make

clear that the shareholder vote on golden parachute arrangements only relates to the agreements/understandings that are covered by the Reform Act.

The Proposed Rules also provide that a company can (but does not have to) satisfy the requirement to disclose potential change in control compensation payments (covered under Item 402(j) of Reg. S-K) in its annual proxy statement by providing the disclosure required under new Item 402(t).

- *When:* The golden parachute compensation arrangements disclosure will not be required for M&A proxy solicitations until the effective date of the SEC's final rules.

Important Exception

- *What:* (Proposed Rule 14a-21(c)). As permitted by the Reform Act, a separate shareholder advisory vote on golden parachute arrangements would not be required in the M&A proxy solicitation if disclosure of the same golden parachute compensation arrangements had been fully included in a previous Say-on-Pay vote (whether or not the shareholders had previously approved the executive compensation). However, if there had been any changes to such golden parachute arrangements (excluding for this purpose movements in the Company's stock price that had occurred over time), then such changes would trigger the disclosure and shareholder vote requirements for the new/revised golden parachute arrangements in the M&A proxy solicitation. In such case, the required disclosure would include two separate tables with one disclosing all of the golden parachute arrangements and the other table disclosing the new/revised arrangements that would be subject to the shareholder advisory vote.

TECHNICAL CLARIFICATIONS AND TRANSITIONAL ITEMS

- *No Requirement to file Preliminary Proxy.* The Proposed Rules provide that Say-on-Pay and Frequency Votes will not trigger a preliminary filing of a proxy statement.

- *No Discretionary Broker Voting.* The Proposed Rules reiterate that broker discretionary voting of uninstructed shares would not be permitted for the Say-on-Pay vote or the Frequency Vote.

- *No Added Requirement for TARP Companies.* Companies with indebtedness under TARP already have a current obligation to conduct a shareholder vote on executive compensation and therefore the Proposed Rules provide that TARP companies would be exempt from having to conduct a Say-on-Pay or Frequency Vote.

- *Transitional Guidance.* The SEC acknowledged that its final rules on Say-on-Pay may not be effective before some companies file proxy statements for shareholder meetings which will occur after

January 20, 2011. Therefore, the SEC provided some first year transitional relief in the Proposed Rules which can be relied on until the final rules are effective. The transitional relief essentially provides that, with respect to certain enumerated items, the SEC will not object if companies operate in a manner consistent with the Proposed Rules.

What Next?

As noted above, the Proposed Rules contain many requests by the SEC for comments on the provisions of the Proposed Rules. Any comments on the Proposed Rules must be submitted by November 18, 2010. Therefore, companies wishing to influence the outcome of the final regulations are urged to review the Proposed Rules and timely submit any comments. Companies may also wish to begin to evaluate what recommendation, if any, they will make with respect to the Frequency Vote and whether or not to provide the enhanced golden parachute disclosures in their next proxy statement in which there will be a Say-on-Pay vote.

As we have previously commented (see for example our blogs from July 26, 2010 *"The Regulatory March to Reform Executive Compensation Practices Takes Another Step Forward"* and March 8, 2010 *"Proxy Season Heats Up as New Executive Compensation Rules are Effective and SEC Provides New Disclosure Guidance"*) companies should regularly evaluate their executive compensation processes, arrangements (especially their golden parachute arrangements given the heightened focus on golden parachutes under the Proposed Rules) and disclosures and seek to improve them if/as needed. If a company's shareholders were to reject a company's disclosed executive compensation or the company were to receive a significant number of negative Say-on-Pay votes, then such a result will not be a desirable outcome for the company or its board of directors.

Therefore, in light of Say-on-Pay, a company's compensation committee may want to consider initiating a review of the company's executive compensation arrangements and expected disclosures, perhaps with the assistance of its own advisors and counsel, and consider making necessary changes in order to best prepared for the 2011 Say-on-Pay vote. Implementing, before the Say-on-Pay vote, what are considered best compensation practices, removing or being prepared to explain/justify what may be perceived as overly risky or excessive compensation arrangements, and developing an organized and clear CD&A may help the company in its effort to receive affirmative Say-on-Pay votes. The formal advent of Say-on-Pay is just a few months away and there is no time like the present to start preparing for it.

If you have any questions regarding this information, please contact Greg Schick at (415) 774-2988.