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SEC Adopts Final Rules Governing Say-On-Pay, Say-On-Frequency, and Golden Parachute Compensation Advisory Votes

By Vincent A. Vietti

On January 25, 2011, the Securities and Exchange Commission (SEC) adopted final rules implementing certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). The final rules were adopted substantially as proposed and will require public companies to obtain non-binding shareholder advisory votes regarding:

- Approval of executive compensation, referred to herein as "say-on-pay;"
- How frequently shareholders will hold say-on-pay votes, referred to herein as "say-on-frequency;" and
- Approval of golden parachute payments in acquisition transactions under certain circumstances.

The rules regarding say-on-pay and say-on-frequency votes are effective immediately and require all public companies holding annual or other meetings of shareholders at which directors will be elected to include shareholder advisory votes on say-on-pay and say-on-frequency if the proxy statement related to such meeting is required to include executive compensation disclosure. The advisory vote regarding golden parachutes will be effective for initial filings made on or after April 25, 2011.

Two-Year Reprieve for Smaller Reporting Companies. Perhaps the biggest departure from the proposal is a temporary exemption for smaller reporting companies. Issuers that satisfy the definition of a "smaller reporting company" (generally, issuers with a public float of less than $75 million) will not be required to seek shareholder advisory votes with respect to say-on-pay or say-on-frequency until their first shareholder meeting at which directors are to be elected occurring on or after January 21, 2013. Smaller reporting companies will, however, be required to comply with the rules applicable to golden parachute payments upon the effective date of such rules.

Say-on-Pay

Section 951 of Dodd-Frank amended the Securities Exchange Act of 1934, as amended (Exchange Act) by adding a new Section 14A(a)(1) that requires all public companies to present to their shareholders an advisory resolution to approve compensation of its named executive officers at least once every three years. New Rule 14a-21(a) requires issuers to obtain a separate shareholder advisory vote on executive compensation in all proxy statements relating to any annual or other shareholder meeting at which directors will be elected and that are required to include executive compensation disclosure. The shareholder vote must approve the compensation disclosed pursuant to Item 402 of Regulation S-K (S-K). In this regard, the instructions to Rule 14a-21 contain the following non-exclusive form of resolution to satisfy the requirement of the rule:

> 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.

S-K Item 402(b) has been amended to require issuers to include in their compensation discussion and analysis (CD&A) whether and, if so, how their compensation policies and decisions have taken into account the results of the most recent shareholder advisory vote on executive compensation. Consistent with the principals-based nature of CD&A, issuers should address their consideration of the results of earlier say-on-pay votes to the extent such consideration is material to the compensation policies and decisions discussed.

New Item 24 to Schedule 14A requires issuers to briefly explain the nature of the vote, such as whether it is non-binding, disclose the current frequency of say-on-pay vote and when the next vote will occur.

Say-on-Frequency

Dodd-Frank further amended the Exchange Act by adding a new Section 14A(a)(2) that requires all public companies to solicit a shareholder advisory vote regarding whether the shareholder vote to approve compensation of executives will occur once every one, two or three years. New Rule 14a-21(b) requires issuers to submit a say-on-frequency proposal in proxy statements for the first annual or other shareholder meetings at which directors will be elected occurring on or after January 21, 2011, that are required to include executive compensation disclosure. Thereafter, say-on-frequency votes will be required once every six calendar years. Like the say-on-pay vote, the say-on-frequency vote is advisory and non-binding on issuers and their board of directors. Shareholders will be asked to determine whether say-on-pay votes should occur once every one, two or three years or abstain and would be prohibited from proposing the frequency of such votes.

Since the vote is advisory, the proposal does not prescribe a standard for determining which frequency has been adopted by the shareholders. To address this issue, the SEC has amended Rule 14a-8 (shareholder proposals), to permit issuers to exclude as "substantially implemented" any shareholder proposal that seeks a say-on-pay or say-on-frequency vote **only** if the issuer has implemented a say-on-frequency vote consistent with the vote of a **majority** of the votes cast by shareholders. As a result, issuers will not be able to exclude a subsequent shareholder proposal regarding say-on-pay or say-on-frequency matters even if it adopts a policy to implement the frequency that received a plurality of the votes cast (i.e., the frequency receiving the most votes even though less than a majority).

Amendment to Form 8-K

Item 5.07 of Form 8-K has been amended to require issuers to disclose how frequently they will conduct shareholder advisory votes on executive compensation in light of the results of the say-on-frequency vote. Issuers will be required to file an amendment to their prior Item 5.07 Form 8-K filing that disclosed the result of the say-on-frequency vote. The amended Form 8-K will be due no later than 150 calendar days after the meeting at which the vote took place, but in no event later than 60 calendar days prior to the deadline for the submission of shareholder proposals under Rule 14a-8 for the subsequent annual meeting, as such date is disclosed in the issuer's proxy materials for the meeting at which the say-on-frequency vote occurred. This change from the proposal was implemented to provide issuers with additional time to consider the results of say-on-frequency vote while providing shareholders ample time to consider whether to submit shareholder proposals on say-on-pay or say-on-frequency.

Additional Amendments

Rule 14a-6 was amended to include say-on-pay and say-on-frequency advisory votes, irrespective of whether such votes are required under Section 14A of the Exchange Act, to the list of items that do not trigger the requirement to file a preliminary proxy statement.

Rule 14a-4 has been amended to permit proxy cards to reflect the choice of one, two or three years, or abstain, in connection with say-on-frequency votes.

Dodd-Frank also amended Section 6(b) of the Exchange Act to direct national securities exchanges to categorize say-on-pay and say-on-frequency votes as non-routine matters that would prohibit broker-discretionary voting of uninstructed shares on these matters. In response, the exchanges have amended their rules to prohibit broker-discretionary voting on these matters.

Golden Parachute Disclosure

Section 951 of Dodd-Frank amended the Exchange Act by adding a new section 14A(b)(1) to require any person making a proxy solicitation relating to a meeting of shareholders to approve a proposed sale, acquisition, merger or similar transaction of an issuer, to include disclosure of any compensation arrangements between the soliciting person and its named executive officers (or with the named executive officers of the acquiring issuer if such issuer is not the acquirer) that are based on or otherwise related to such transaction. Section 14A(b)(1) also requires disclosure of any such arrangements that an acquiring issuer has with its named executive officers or with the named executive officers of the target in transactions in which the acquiring issuer is making a proxy or consent solicitation. Unless such golden parachute arrangements have been previously subject to a separate say-on-pay vote, issuers are required to obtain a separate shareholder advisory vote to approve any such arrangements.

In response, the SEC proposed a new S-K Item 402(t) to require in all proxy statements seeking approval of a merger or similar transaction, disclosure of all golden parachute compensation arrangements among the target and acquiring companies and the named executive officers of each. S-K Item 402(t) was adopted substantially as proposed and requires, in tabular form, quantitative disclosure of all individual elements of compensation an executive is entitled to receive that are based on or otherwise relate to the acquisition transaction, including base salary, bonus, non-equity incentive arrangements, acceleration of stock awards, pension and non-qualified deferred compensation benefit enhancements, perquisites, tax reimbursements and all other compensation. Footnote disclosure is required to disclose whether such elements are "single-trigger" or "double-trigger" arrangements. Separate narrative disclosure requires a description of any material conditions or obligations applicable to receipt of payment, such as non-competition, non-solicitation, non-disparagement or confidentiality arrangements, the specific circumstances that would trigger a payment, whether payments would be lump sum or annual, their duration and by whom payment would be provided. Based on Dodd-Frank's requirement that **all** compensation due in connection with such transactions be disclosed, there is no exclusion for **de minimis** perquisites and other benefits.

In response to comments requesting greater flexibility, issuers are permitted to include additional executive officers and additional rows or columns to the table. As Dodd-Frank only requires advisory votes to approval payments "that are based on or otherwise relate" to the change of control transaction, S-K Item 402(t) will not require disclosure of: (1) previously vested equity awards; or (2) **bona fide** post transaction employment agreements.

Advisory Vote Regarding Golden Parachute Payments

Section 951 of Dodd-Frank also added a new Section 14A(b)(2) to the Exchange Act to require a separate shareholder advisory vote on golden parachute arrangements required to be disclosed under Section 14A(b)(1) in connection with merger or similar transactions. Final Rule 14a-21(c) requires issuers to provide for separate shareholder advisory votes **only** when such shareholders are asked to approve an acquisition, merger, consolidation, sale of all or substantially all assets, or similar transaction. For example, if the issuer is seeking approval to increase its authorized shares to complete an acquisition, an advisory vote on such arrangements would not be required even though disclosure of golden parachute arrangements may be included in the proxy statement.

In addition, the vote is required **only** with respect to those arrangements required to be disclosed under Section 14A(b)(1) of the Exchange Act. Target issuers conducting such solicitations are, therefore, only required to obtain an advisory vote with respect to those golden parachute arrangements between such target and its named executive officers, notwithstanding the broader disclosure required by S-K Item 402(t).

Under Dodd-Frank, the shareholder advisory vote is not required if the golden parachute arrangements at issue have been previously disclosed and subject to a say-on-pay vote. This exception only applies if the arrangements approved remain in effect and have not been modified. Changes relating to the value of the items presented to reflect changes in the price of the issuer's securities or that result only in a reduction in value of the total compensation, would not be viewed as modifications and would not require a new advisory vote. Changes in compensation and additional issuances of equity compensation, even in the ordinary course, would be viewed as changes and would require a new vote only with respect to such new arrangements and revised terms. Issuers seeking to satisfy this exception must include S-K Item 402(t) disclosure in their annual meeting proxy statement.

Related Acquisition Transactions

In order to prevent issuers from structuring transactions in a manner that avoids the requirement to solicit proxies, such as a tender offer or certain going-private transactions, the final rules require golden parachute disclosure not only in proxy or consent solicitations, but also in:

- Information statements filed pursuant to Regulation 14C;
- Registration statements on Forms S-4 and F-4 containing disclosure relating to mergers and similar transactions;
- Going-private transactions on Schedule 13E-3; and
- Third-party tender offers on Schedule TO and Schedule 14D-9 solicitation/recommendation statements.

With regard to tender offers, third-party bidders are not required to include S-K Item 402(t) disclosure as such bidders may face difficulties in obtaining such information and target companies will be required to provide such information in the Schedule 14A-9 required to be filed by it in response to such an offer. Disclosure of golden parachute arrangements will, however, be required in third-party tender offers that are also Rule 13e-3 going-private transactions.

Smaller Reporting Companies

The SEC initially proposed the new rules would be applicable to smaller reporting companies. After considering numerous comments, the SEC adopted the following compromise:

- The provisions requiring say-on-pay and say-on-frequency advisory votes will not be applicable to smaller reporting companies until their first shareholder meeting at which directors are to be elected occurring on or after January 21, 2013; and

- The provisions requiring disclosure or golden parachute payments in connection with change in control transactions and advisory shareholder votes are effective April 25, 2011.

The SEC concluded that delayed implementation of say-on-pay and say-on-frequency votes would provide smaller reporting companies with the opportunity to observe the disclosure practices of larger companies and the SEC with time to determine whether any adjustments should be made for smaller reporting companies. As such issuers are not required to provide CD&A disclosure, the amendments to S-K Item 402(b) would not apply to smaller reporting companies.

The SEC has recently issued a number of Compliance and Disclosure Interpretations (CDIs) regarding issuers transitioning in or out of smaller reporting company status. These CDIs generally provide that the determination of whether an issuer can rely on the delayed phase-in period for smaller reporting companies is based on the issuer's status as of January 21, 2011. Issuers transitioning into smaller reporting company status in 2011 (i.e., was not a smaller reporting company in 2010 but will be in 2011) are entitled to rely on the delayed phase-in period as such issuers would attain the status of a smaller reporting company on and as of January 1, 2011. Issuers transitioning out of smaller reporting company status in 2011 (i.e., was a smaller reporting company in 2010 but will not be in 2011) would not be entitled to rely on the delayed phase-in period as such issuers would lose their status as a smaller reporting company on and as of January 1, 2011, even though such issuers would be permitted to file its Form 10-K for 2010 as a smaller reporting company.

SEC Proposes Revised Minimum Net Worth Standard for Accredited Investor Status

By Vincent A. Vietti

Section 413(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) increased the minimum net worth required for a natural person to be considered an "accredited investor" under Regulation D under the Securities Act of 1933, as amended (Securities Act). Specifically, the value of a natural person's primary residence must be **excluded** in determining whether the net worth of such person, or joint net worth together with the person's spouse, exceeds the $1 million threshold required for such person to be considered an "accredited investor." Section 413(b) of Dodd-Frank directs the SEC to review the definition of "accredited investor" every four years. On January 25, 2011, the SEC proposed to formally amend the definition of "accredited investor" to comply with Dodd-Frank. The SEC is not proposing to make any additional revisions to the definition of "accredited investor."

Background

SEC Rule 501 defines an "accredited investor" to include any natural person whose individual net worth, or joint net worth with his or her spouse, exceeds $1 million. Prior to Dodd-Frank, investors were permitted to include the value of his or her primary residence in calculating such net worth. Shortly after Dodd-Frank became law, the Securities and Exchange Commission Division of Corporate Finance (Division) withdrew its prior public interpretation that permitted natural persons to include in their net worth calculation the value of their primary residence and issued a new interpretation requiring investors to exclude the value of their primary residence in such calculation.

Proposed Rule

The SEC is proposing to formally amend the net worth standard set forth in SEC Rules 215 and 501 to comply with Section 413(a) of Dodd-Frank as follows:

> Any natural person whose individual net worth, or joint net worth with that person's spouse at the time of purchase, exceeds $1,000,000, excluding the value of the primary residence of such natural person, calculated by subtracting from the estimated fair market value of the property the amount of debt secured by the property, up to the estimated fair market value of the property.

The revised rule has the effect of deducting from an investor's net worth the net equity in his or her primary residence. In calculating net worth, investors would total all assets (including the value of his or her primary residence), deduct all liabilities (including all debt secured by such primary residence) and then adjust the result by excluding the value of the primary residence and the amount of debt secured by such residence but only up to the value of such residence. Indebtedness secured by the residence in excess of the value of such residence is considered a liability and would continue to be deducted from the investor's net worth. The SEC explained that to exclude all debt secured by a primary residence irrespective of the value of such residence would result in an increase in the net worth of investors whose mortgages exceed the value of their primary residence. The SEC is seeking comment on a number of technical points, including whether to exclude the value of the primary residence but not any indebtness secured by the residence. Comments are due March 11, 2011, and a final rule is expected to be issued shortly thereafter.

What It Means

The proposal simply codifies the Division's interpretation of Section 413(a) of Dodd-Frank, in effect since July 21, 2010. If adopted as proposed, there will be no change in the existing law. In the release, the SEC cited data from the 2007 Federal Reserve Board Survey of Consumer Finances that estimated that 9.04% of U.S. households qualified for accredited investor status on the basis of the net worth standard prior to Dodd-Frank. As a result of excluding home equity, it is estimated that approximately 5.91% of households would continue to qualify. By reducing the pool of accredited investors, the increased threshold could make it more difficult to raise capital on a private placement basis. Issuers raising capital on a private placement basis should review, and if necessary revise, any private offering memoranda and securities purchase or similar agreements to ensure investors who purchase their securities meet the new accredited investor standard.

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