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SEC Proposes Rules for Say-on-Pay, Say-on-Frequency, and Golden Parachute Compensation Advisory Votes

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The Securities and Exchange Commission (SEC) recently issued proposals to amend several proxy and disclosure rules to implement various provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). The proposed rules will require all public companies to obtain 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 new rules are expected to be approved and become effective for the 2011 proxy season. Irrespective of whether the proposed rules are adopted, **all public companies holding annual or special shareholder meetings on or after January 21, 2011**, will be required to include shareholder advisory votes on say-on-pay and say-on-frequency if the proxy related to such meeting is required to include executive compensation disclosure. The advisory vote regarding golden parachutes **will not** be required unless and until the proposed rules are adopted.

Public companies holding meetings on or after January 21, 2011, that file preliminary or definitive proxy materials prior to the SEC adopting any final rules will be able to rely on the following transition rules:

- If the only matters that would otherwise require the filing of a preliminary proxy statement are the advisory votes on say-on-pay and say-on-frequency, **no** preliminary filing will be required; and
- Issuers will be permitted to use forms of proxy that permit shareholders to vote among the following four alternatives: frequencies of one, two or three years or abstaining. Current SEC proxy rules provide only for votes of for, against or abstain.

Say-on-Pay

Section 951 of Dodd-Frank amended the Securities Exchange Act of 1934, as amended (Exchange Act), to add a new Section 14A(a)(1) to require 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. The results of the vote will be non-binding on issuers and their board of directors and will be effective for all proxy statements relating to annual or special shareholder meetings occurring on or after January 21, 2011 that are required to include executive compensation disclosure.

The SEC is also proposing to amend Item 402(b)(2) of Regulation S-K (S-K) 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 shareholder advisory votes on executive compensation. The shareholder vote would relate to all executive compensation disclosure set forth in the proxy statement pursuant to S-K Item 402.

Say-on-Frequency

Dodd-Frank further amended the Exchange Act to add a new Section 14A(a)(2) requiring 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. The proposed rule requires issuers to submit a say-on-frequency proposal in all proxy statements for annual or special meetings 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 years. Like the say-on-pay vote, the say-on-frequency vote would be 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. However, for purposes of Rule 14a-8 (shareholder proposals), the SEC is proposing issuers may 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 plurality of the votes cast by shareholders (i.e., the choice receiving the most votes). The proposal would also require issuers to disclose the general effect of the say-on-frequency vote, including whether the vote is binding on the issuer or its board of directors.

Finally, the proposed rules would add a new item 9B to Form 10-K and a new Item 5(c) to Part II to Form 10-Q which will require issuers to disclose in the quarterly or annual report covering the period in which the advisory vote occurs, its decision regarding how frequently it will conduct shareholder advisory votes on executive compensation in light of the results of such vote.

Additional Proposed Amendments
The proposed rules regarding say-on-pay and say-on-frequency votes would amend various other SEC rules, including:

- Rule 14a-6 to include say-on-pay and say-on-frequency advisory votes to the list of items that do not trigger the requirement to file a preliminary proxy statement; and
- Requiring 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.

Golden Parachutes

Section 951 of Dodd-Frank amended the Exchange Act by adding a new section 14A(b)(1) requiring any person making a proxy solicitation relating to a shareholder meeting to approve a proposed sale, acquisition, merger or similar transaction of an issuer, to disclose any compensation arrangements such person has with any of the named executive officers of such issuer (or of the acquiring issuer) that are based on or otherwise related to such transaction. Unless such golden parachute arrangements have been previously subject to a separate say-on-pay vote, the issuer would be required to obtain a separate shareholder advisory vote to approve any such arrangements. Unlike the say-on-pay and say-on-frequency advisory votes, the advisory vote with respect to golden parachute compensation arrangements will not be effective unless and until the SEC adopts the proposed rules.

Proposed S-K Item 402(t) would require, in all proxy statements seeking approval of a merger or similar transaction, disclosure of not only all golden parachute compensation arrangements between the target issuer conducting the solicitation and its named executive officers, but also agreements or understandings between the acquiring company and the named executive officers of the target company. Proposed S-K Item 402(t) would require a table disclosing all individual elements of compensation that an executive would 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 would be required as to whether such elements are "single-trigger" or "double-trigger" arrangements. Separate narrative disclosure would require 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 who would provide payment.

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 proposal requires such 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.

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 mergers or similar transactions. Proposed Rule 14a-21 would require issuers to provide for separate shareholder advisory votes with respect to only those arrangements required to be disclosed under Section 14A(b)(1) of the Exchange Act. Target issuers conducting such solicitations would, therefore, only be required to obtain an advisory vote regarding 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 foregoing 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. Issuers seeking to satisfy this exception must include S-K Item 402(t) disclosure in their annual meeting proxy statements. Such issuers would be deemed to have satisfied their current S-K Item 402(j) disclosure requirements relating to payments due in connection with a change in control by providing the disclosure required by S-K Item 402(t). Issuers would, however, still be required to include disclosure required by current S-K Item 402(j) of payments due upon termination of employment.

Smaller Reporting Companies

Although Dodd-Frank authorizes the SEC to exempt smaller reporting companies from the new rules, the SEC has preliminarily determined the proposed rules do not disproportionately burden smaller companies. As a result, the rules will apply to smaller reporting companies and would not change the scaled disclosure requirements currently applicable to such issuers. For example, smaller reporting company will not be required to provide a CD&A in order to comply with the new rules. The SEC noted that current S-K Item 402(o) requires smaller reporting companies to provide a narrative description of any material factors necessary to an understanding of the issuer's summary compensation table. If consideration of prior advisory votes on executive compensation is a factor for a particular issuer, disclosure would be required pursuant to this item. The SEC is, nevertheless, seeking comment regarding whether smaller reporting companies should be exempt from the say-on-pay advisory vote requirement, and if applicable, whether smaller reporting companies should be required to address the consideration of previous shareholder advisory votes on executive compensation.

What's Next

Dodd-Frank imposes a number of additional executive compensation and corporate governance requirements on public companies that will become effective as rules are adopted by the SEC and/or national securities exchanges. These reforms include:

- **Compensation Committees** – enhanced independence standards, sole discretion to retain and direct compensation consultants after evaluating independence factors to be determined by the SEC, and disclosure regarding the use of such consultants. The SEC has been directed to adopt rules no later than July 21, 2011;
- **Pay vs. Performance** – will require proxy disclosure showing the relationship between executive compensation paid and financial performance. The SEC has been directed to amend S-K Item 402 to implement; however, no time frame was established;
- **Median Compensation** – will require proxy disclosure showing the relationship between CEO compensation and the median compensation for all employees excluding the CEO. The SEC has been directed to amend S-K Item 402 to implement; however, no time frame was established; and
- **Clawbacks** – will require issuers to develop policies regarding disclosure of incentive-based compensation tied to financial performance and recovery of such compensation from current or former executive officers in the event of a restatement with a look-back period of three years. The SEC is required to direct national securities to prohibit listing issuers that do not adopt such policies; however, no time frame was established.

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