October 22, 2010

SEC Proposes "Say on Pay" and "Say When on Pay" Rules

The SEC has released proposed rules[1] on the advisory shareholder votes now required to approve:

- Executive compensation (the "say-on-pay" vote);
- The frequency of such say-on-pay vote (the "say-when-on-pay" vote); and
- Change-in-control compensation (the "golden parachute" vote) and the disclosure for such vote.

(The say-on-pay vote, say-when-on-pay vote, and golden parachute vote are referred to collectively here as the "Advisory Votes.") Final rules on the Advisory Votes will be adopted after the comment period closes on November 18, 2010. Most U.S. public companies are required to hold say-on-pay and say-when-on-pay votes at their 2011 annual meetings (or other meeting of the shareholders under certain conditions) if the meeting will occur on or after January 21, 2011 -- regardless of whether or not the rules proposed by the SEC have been adopted before the 2011 proxy season commences. However, the SEC indicates in its proposing release that companies that file merger proxy statements relating to a shareholder meeting would not be required to hold a golden parachute vote or make the new related disclosures until the effective date of the final rules for the golden parachute vote and related disclosure. A summary of the key provisions of the proposed rules related to the Advisory Votes follows:[2] **General Provisions**

- *No Preliminary Proxy Statement Required.* None of the Advisory Votes would require a company to file a preliminary proxy statement.
- *Required Proxy Statement Disclosure Regarding the Nature and Effect of Advisory Votes.* A company would be required to briefly explain the nature and general effect of holding an Advisory Vote, such as the fact that the vote will not be binding on the company and its board of directors.

Say-on-Pay

- *Structure of Advisory Vote.* No specific language or form of resolution to be voted upon would be required, although shareholders would need to be given the opportunity to vote to approve the compensation of the company's named executive officers ("NEOs") as set forth in the Compensation Discussion and Analysis ("CD&A"), the compensation tables, and other narrative executive compensation disclosures required by Regulation S-K Item 402.
    - Additional disclosure of golden parachute compensation is not required, nor is a golden parachute vote, though a company may voluntarily choose to subject such compensation to the say-on-pay vote.
    - A vote simply to approve only a company's "executive compensation policies and procedures" would not satisfy the requirement.
    - A company may, but is not required to, hold additional votes on other aspects of compensation such as on cash compensation levels, golden parachute policies, and severance structures.
- *Excluded Items: Compensation Risk and Director Compensation.* Under the proposed rules, neither director compensation nor disclosure, if any, of compensation risk management practices and risk-taking incentives are subject to the say-on-pay vote requirement. However, if a company is required to discuss compensation risk policies or practices as part of its CD&A because such policies or related decisions are a material aspect of the compensation of its NEOs, such disclosures could be considered by shareholders as part of the say-on-pay vote.

- *Influence of Prior Advisory Votes on Executive Compensation Must Be Discussed in CD&A.* Under the proposed rules, a company would be required to address in its CD&A whether and, if so, how the results of prior advisory votes on executive compensation have been taken into account.

Say-When-on-Pay

- *Mandatory Structure of Vote.* Under the proposed rules, shareholders would indicate their preference on the frequency of say-on-pay votes by selecting among three choices -- for an annual, biennial, or triennial say-on-pay vote -- or by abstaining from voting on the matter.[3]
    - A company would not be permitted to structure its vote in an alternate manner, such as by asking shareholders to select between two choices (e.g., an annual vote or a less frequent vote) or to vote "for" or "against" a company recommendation (e.g., to hold a say-on-pay vote on a biennial basis).
    - The SEC is seeking comments on whether such approach would be technically feasible. Some commentators have noted that this type of "multiple choice" voting option would not be operationally possible.
    - Until the final rules take effect, the SEC will not object if the proxy card for a say-when-on-pay vote provides a choice among 1, 2, or 3 years, provided that companies using this approach may not exercise voting discretion with respect to the say-when-on-pay vote.
- *Board Recommendation Permitted.* The board of directors would be permitted to recommend how shareholders should vote, provided that the company also clarifies that shareholders are not being asked to approve the company's recommendation and are free to choose any of the choices presented on the proxy card.
- *Future Shareholder Proposals Excluded.* Under the proposed rules, if a company uses a plurality voting model, it would be permitted to exclude future shareholder proposals seeking a say-when-on-pay vote on the basis that the proposal has already been "substantially implemented," provided that the company adopts the frequency that is consistent with the prior plurality vote.
  The SEC release states that this voting standard applies only to the staff's determination regarding whether the say-on-pay frequency standard that had received the most votes was adopted for purposes of the proposed rules and not for the purpose of state law.
- *Periodic Report Must Disclose the Frequency Standard Adopted.* Pursuant to the proposed rules, a company would be required to disclose in its periodic report covering the period during which the say-when-on-pay vote occurs its decision regarding how frequently it will conduct the say-on-pay vote in light of the results of the say-when-on-pay vote.

Golden Parachute Vote and Related Disclosure

- *Structure of Vote -- Solicitation to Approve Applicable Transaction.* No specific language or form of resolution to be voted upon by shareholders would be required for a golden parachute vote held at the same time as a vote on the transaction potentially giving rise to the golden parachute compensation.
- *Structure of Vote -- Solicitation to Approve Say-on-Pay.* Under the proposed rules, a company would be permitted to include its golden parachute compensation as part of its say-on-pay vote at an annual meeting, provided its executive compensation disclosures include the disclosures required under the new rules applicable to golden parachute compensation.
    - A company would not be required to resubmit the golden parachute compensation to shareholders for an Advisory Vote at the later time of a merger or other transaction that would have otherwise required a golden parachute vote, provided the same golden parachute compensation previously subject to the Advisory Vote remains in effect. As a result, the SEC anticipates that some companies will voluntarily include the new disclosures regarding golden parachute compensation as part of their say-on-pay vote, even if a transaction requiring disclosure or a vote is not pending.
    - Only new and/or revised golden parachute compensation would be subject to the separate Advisory Vote if a company later solicits its shareholders for approval of a transaction requiring a golden parachute

compensation vote. In this case, the company would present an additional compensation table showing only the new or revised golden parachute compensation subject to the vote.

- Transactions Subject to a Golden Parachute Vote. The types of transactions that trigger an advisory vote under the proposed rules include a merger, acquisition, consolidation, or proposed sale or other disposition of all or substantially all of the assets of a company.
- *Transactions Triggering Disclosure Requirements Expanded.* Under the proposed rules, the SEC seeks to expand the class of transactions subject to the new golden parachute compensation disclosures by extending the disclosure requirement to going-private transactions and tender offers. As a result, certain transactions will trigger golden parachute compensation disclosure, even though shareholders are not required to be given a golden parachute vote on such arrangements.
- *Golden Parachute Compensation Subject to the Advisory Vote.* Under the proposed rules, the advisory vote would only cover information on golden parachute compensation that the "person making the solicitation" has (i) with the company for which shareholders are asked to approve the applicable transaction; and (ii) with the acquiring company, if the soliciting person is not the acquiring company.
    - This means that if a target company solicits shareholder approval of a merger or similar transaction, the golden parachute vote would not cover arrangements between the acquiring company and the target company's NEOs, although as discussed directly below, the target company would be required to disclose such arrangements in its merger proxy statement.
- *Compensation Required to Be Disclosed Expanded to Include All Arrangements Between NEOs and Target and/or Acquirer.* In order to cover the full scope of golden parachute compensation applicable to a transaction, the proposed SEC rules would require disclosure of all golden parachute compensation relating to the transaction among the target and acquiring companies and the NEOs of each.
- *New Tabular and Narrative Disclosures.* Under the proposed rules, a company would be required to present quantitative disclosure of each element of compensation that an NEO would receive in connection with the transaction, as well as the total for each NEO. A company also would need to describe the material elements applicable to the receipt of payment under the golden parachute arrangements. These narrative disclosures are generally consistent with the disclosures currently required on an annual basis with respect to termination and change-in-control agreements with NEOs.
- Specific elements that would require separate quantification include:
    - Any cash severance payment (e.g., base salary, bonus, and incentive plan payments);
    - The value of accelerated stock and option awards and payments in cancellation of stock and option awards;
    - Pension and nonqualified deferred compensation benefit enhancements; and
    - Perquisites (with no de minimis exception) and other personal benefits (including general health and welfare plans available to all employees) -- with a separate column included to report any tax reimbursements.
- A catchall "other" column would pick up any other elements of compensation not specifically included in the table.
- Footnote disclosure would identify which payments would require a double trigger (i.e., a change in control and termination) and the payments that would be subject to a single trigger (i.e., a change in control).

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[1]Shareholder Approval of Executive Compensation and Golden Parachute Compensation; Release Nos. 33-9153; 34-63124 [October 10, 2010] (the "SEC Release") -- available here. [2]Under the proposed rule, a TARP company that conducts an annual shareholder vote to approve executive compensation pursuant to the Emergency Economic Stabilization Act of 2008 would not be required to conduct a separate shareholder vote on executive compensation or conduct a "say-when-on-pay" vote until such company has repaid all indebtedness under the TARP. Although the SEC is seeking comment regarding whether it would be appropriate to exempt smaller reporting companies from the say-on-pay vote, in general the proposed

SEC rules are drafted to apply equally to smaller reporting companies. [3]The SEC rules related to the proxy card would be revised to require proxy cards to present the full menu of "say-when-on-pay" choices (e.g., 1, 2, or 3 years, or abstain).