



## **SEC Adopts Rules Concerning Shareholder Votes on Say-On-Pay and Golden Parachute Compensation**

**Presented By:**

**The Public Companies Group**

On January 25, 2011, the Securities and Exchange Commission (the "SEC") adopted final rules to implement provisions of Section 14A of the Securities Exchange Act of 1934 (the "Exchange Act"), a new section of the Exchange Act added by Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The final rules address requirements set forth in Section 14A concerning (1) shareholder approval of executive compensation (a so-called, "say-on-pay" vote), (2) shareholder approval of the frequency with which such say-on-pay votes are put before shareholders and (3) shareholder approval of, and disclosures regarding, compensation based on or otherwise relating to an acquisition, merger, consolidation, sale or other similar disposition (so-called "golden parachute" arrangements).

## The Final Rules

### 1. Shareholder Approval of Executive Compensation (Say-On-Pay)

**Rule 14a-21(a):** The SEC adopted new Exchange Act Rule 14a-21(a), pursuant to which issuers will be required, not less frequently than once every three calendar years, to provide a separate shareholder advisory vote in proxy statements to approve the compensation of the issuer's named executive officers. The final rule specifies that the separate shareholder say-on-pay vote is required only when proxies are solicited for an annual or other meeting of shareholders at which directors will be elected and for which SEC rules require the disclosure of executive compensation pursuant to Item 402 of Regulation S-K. As mandated by Section 14A, the rule requires the vote at the first such annual or other meeting of shareholders occurring on or after January 21, 2011. Shareholders will vote to approve the compensation of the issuer's named executive officers, as such compensation is disclosed in Item 402 of Regulation S-K, including the Compensation Discussion and Analysis ("CD&A"), the compensation tables and other narrative executive compensation disclosures required by Item 402. The instructions to the rule indicate, however, that the compensation of directors, as disclosed pursuant to Item 402(k) and Item 402(r) of Regulation S-K, is not subject to the shareholder advisory vote. The adopting release states that the final rule does not require issuers to use any specific language or form of resolution; however, an instruction to the rule requires the resolution to indicate that the compensation being

approved is “as disclosed under Item 402 of Regulation S-K.” The instruction also includes a non-exclusive example of a resolution that would satisfy the applicable requirements.

**Item 24 to Schedule 14A:** The SEC also adopted new Item 24 to Schedule 14A requiring issuers to disclose in a proxy statement covering a say-on-pay vote that they are providing such vote as required pursuant to Section 14A, and to briefly explain the general effect of the vote, such as whether the vote is non-binding. Similarly, issuers will be required to disclose in a proxy statement covering a frequency of say-on-pay vote that they are providing such vote as required pursuant to Section 14A, and to briefly explain the general effect of such a vote. Item 24 also requires, in any proxy statement covering a say-on-pay vote or a frequency of say-on-pay vote, disclosure of the current frequency of the say-on-pay vote and the when the next say-on-pay vote will occur. No disclosure of current frequency or when the next say-on-pay vote will occur is required in the proxy statement for the meeting at which an issuer first conducts the say-on-pay and frequency of say-on-pay votes.

**Amendments to Item 402(b) of Regulation S-K:** The SEC adopted amendments to Item 402(b) of Regulation S-K to require issuers to address in the CD&A whether and, if so, how their compensation policies and decisions have taken into account the result of the most recent shareholder advisory vote on executive compensation. The amendments add a new clause (vii) to the enumerated elements required to be discussed in the CD&A pursuant to Item 402(b)(1). The SEC notes in the adopting release that the amendment to Item 402(b)(1) is not mandated by Section 951 of the Dodd-Frank Act, but that the SEC “believe[s] that including this mandatory topic in CD&A will facilitate better investor understanding of issuers’ compensation decisions.”

## **2. Shareholder Approval of the Frequency of Say-On-Pay Voting**

**Rule 14a-21(b):** The SEC adopted new Exchange Act Rule 14a-21(b), pursuant to which issuers will be required, not less frequently than once every six calendar years, to provide a separate shareholder advisory vote in proxy statements to determine whether the say-on-pay vote will occur every one, two, or three years. The final rule specifies that the separate shareholder say-on-pay vote is required only when proxies are solicited for an annual or other meeting of shareholders at which directors will be elected and for which SEC rules

require the disclosure of executive compensation pursuant to Item 402 of Regulation S-K. The frequency of say-on-pay vote rule does not require issuers to use any specific language or form of resolution. Unlike the say-on-pay vote rule, the frequency of say-on-pay vote rule does not provide an example of a form of resolution.

**Amendment to Rule 14a-4:** The SEC also adopted amendments to Exchange Act Rule 14a-4 to reflect the statutory requirement that shareholders must be provided the opportunity to vote on whether the say-on-pay vote will occur every one, two, or three years. Accordingly, the SEC adopted amendments to Rule 14a-4, which provides the specific requirements as to the form of proxy that issuers are required to include with their proxy materials, to require that issuers present these four choices to their shareholders: whether the shareholder vote on executive compensation will occur every one, two, or three years, or to abstain from voting on the matter. The SEC expects that the board of directors of the issuer will make a recommendation as to how shareholders should vote on the frequency of say-on-pay votes, but the adopting release provides that the issuer must make clear in these circumstances that the proxy card provides for all four of the choices noted above and that shareholders are not voting simply to approve or disapprove the issuer's recommendation.

**Amendment to Rule 14a-8:** The SEC amended Exchange Act Rule 14a-8 to add a new note permitting the exclusion of a shareholder proposal that would provide for a say-on-pay vote or seeks future say-on-pay votes or that relates to the frequency of say-on-pay votes, provided the issuer has adopted a policy on the frequency of say-on-pay votes that is consistent with the majority of votes cast in the most recent vote in accordance with Rule 14a-21(b). In the adopting release, the SEC acknowledges that with three substantive choices as to frequency, it is possible that no single choice will receive a majority of votes. As a result, an issuer that does not obtain a majority vote on a particular frequency may not be able to exclude a shareholder proposal on say-on-pay matters—even if it has adopted a frequency consistent with the plurality vote of the shareholders.

**Amendments to Form 8-K:** The SEC has adopted amendments to Item 5.07 of Form 8-K to require disclosure of an issuer's decision on the frequency of say-on-pay votes. Item 5.07 currently requires prompt disclosure of the results of preliminary and final results of

shareholder votes. To comply with the newly adopted Item 5.07 requirement, an issuer must file an amendment to its prior Form 8-K filing or filings under Item 5.07 that disclosed the results of the shareholder vote on frequency. This amended Form 8-K will be due no later than 150 calendar days after the date of the end of the meeting at which the frequency of say-on-pay 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. In the amended Form 8-K, the issuer must disclose its determination regarding the frequency of say-on-pay votes. Form 8-K disclosure of the issuer's decision was adopted in lieu of Form 10-Q/Form 10-K disclosure, as was originally proposed by the SEC.

**Amendments to Rule 14a-6:** Amendments to Exchange Act Rule 14a-6(a) provide that a proxy statement that includes a solicitation with respect to a say-on-pay vote, a vote on the frequency of the say-on-pay vote or any other shareholder advisory vote on executive compensation will not trigger a requirement that the issuer file the proxy statement in preliminary form.

### **3. Shareholder Approval and Disclosure of Golden Parachute Arrangements**

**Rule 14a-21(c):** The SEC adopted new Exchange Act Rule 14a-21(c), which requires that a proxy statement to approve an acquisition, merger, consolidation or proposed sale or disposition of all or substantially all assets of an issuer also include a separate advisory shareholder vote to approve the issuer's golden parachute arrangements with its named executive officers.

This separate shareholder vote is not required if the arrangements were subject to a prior shareholder vote in the issuer's say-on-pay vote in an annual meeting proxy statement that included the disclosure described below in new Item 402(t) of Regulation S-K. However, if there is any change to the terms of these arrangements, or if any new arrangements are adopted, subsequent to when the arrangements were subject to the say-on-pay vote, then a new shareholder vote must be included in the change in control proxy statement for the new or revised arrangements, and the proxy statement must include disclosure of the prior and current arrangements. Moreover, Institutional Shareholder Services ("ISS") has indicated that when the golden parachute vote is included in the say-on-pay vote, ISS will

give greater weighting to that component of its evaluation (which could have adverse implications if any golden parachute arrangements contain a “problematic pay practice” under ISS guidelines).

**Item 402(t) of Regulation S-K:** In addition to the shareholder vote, the proxy statement must include detailed disclosure of the golden parachute arrangements of the named executive officers. This disclosure requirement is contained in new Item 402(t) of Regulation S-K, which requires disclosure in both tabular and narrative formats. The following table must be included in the proxy statement:

**Golden Parachute Compensation**

Name (a)	Cash (\$) (b)	Equity (\$) (c)	Pension/ NQDC (\$) (d)	Perquisites/ Benefits (\$) (e)	Tax Reimbursement (\$) (f)	Other (\$) (g)	Total (\$) (h)
PEO							
PFO							
A							
B							
C							

The table presents quantitative disclosure of the individual elements of compensation that an executive would receive that are based on or otherwise relate to the change in control transaction, and the total for each named executive officer. Elements that must be separately quantified and included in the total include any cash severance payment (*e.g.*, base salary, bonus and pro-rata non-equity incentive plan compensation payments) (column (b)); the dollar value of accelerated stock awards, in-the-money option awards for which vesting would be accelerated, and payments in cancellation of stock and option awards (column (c)); pension and nonqualified deferred compensation benefit enhancements (column (d)); perquisites and other personal benefits and health and welfare benefits (column (e)); and tax reimbursements (*e.g.*, Internal Revenue Code Section 280G tax gross-ups) (column (f)); and any additional elements of compensation not specifically includable in the other columns of the table (column (g)). The last column must show the aggregate total of all such compensation (column (h)).

Each column (other than the total column) requires footnote identification and quantification of each separate form of compensation reported for each named executive officer. Each column also requires separate footnote identification of amounts attributable to “single-trigger” arrangements and amounts attributable to “double-trigger” arrangements, so that shareholders can readily discern these amounts.

The SEC in the adopting release notes the differences between the compensation required to be disclosed under Item 402(t) and the information already required to be disclosed in annual proxy statements under Item 402(j) (payments upon termination of employment or change in control). Specifically, Item 402(t) also requires disclosure of (i) the total compensation payable to each named executive officer, (ii) de minimis perquisites and other benefits, and (iii) arrangements that do not discriminate in favor of executives and that are available generally to all salaried employees.

Item 402(t) also requires issuers to describe any material conditions or obligations applicable to the receipt of payment, including non-compete, non-solicitation, non-disparagement or confidentiality agreements, their duration, and provisions regarding waiver or breach. The rule also requires issuers to provide a description of the specific circumstances that would trigger payment, whether the payments would or could be lump sum, or annual, and their duration, and by whom the payments would be provided, and any material factors regarding each agreement. Issuers are permitted to add additional named executive officers, and additional columns or rows to the tabular disclosure, such as to disclose cash severance separately from other cash compensation or to distinguish “single-trigger” and “double-trigger” arrangements, so long as such disclosure is not misleading.

When Item 402(t) disclosure is included in a change in control proxy statement, it must be quantified assuming the event took place on the last practicable date, and quantification of dollar amounts based on stock price will be based on the consideration per share in the change in control transaction, if such value is a fixed dollar amount, or otherwise on the average closing price per share over the first five business days following the first public announcement of the transaction. When Item 402(t) disclosure is included in an annual meeting proxy statement, it is assumed that the event took place on the last business day of the fiscal year and the price per share is the closing market price on such date.

**Amendments to Schedule 14A, Schedule 14C, Schedule 14D-9, Schedule 13E-3, and Item 1011 of Regulation M-A:** The SEC also adopted various schedule and regulation amendments to require the Item 402(t) disclosures to be included in:

- 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;
- 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
- certain third-party tender offers on Schedule TO and Schedule 14D-9 solicitation/recommendation statements.

### **Effect on TARP Issuers and Smaller Reporting Companies**

Issuers participating in the Troubled Asset Relief Program ("TARP") must conduct a say-on-pay vote under TARP, but generally are not required to comply with the Rule 14a-21 say-on-pay and frequency of say-on-pay rules until they have repaid all of their outstanding indebtedness under TARP.

Smaller reporting companies (companies with a public float of less than \$75 million) are subject to the final rules, subject to a two-year delayed effective date with respect to the say-on-pay and say-on-pay frequency rules. Accordingly, smaller reporting companies do not have to hold say-on-pay or frequency of say-on-pay votes until their first annual or other meeting at which directors are elected occurring on or after January 21, 2013.

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A copy of the final release is available at <http://www.sec.gov/rules/final/2011/33-9178.pdf>. If you have any questions concerning the rules, we urge you to contact any member of the Public Companies Client Service Group.

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