

# SEC Releases Proposed Rules on Say-on-Pay and Say-on-Parachute Provisions of the Dodd-Frank Act

October 27, 2010

On October 18, 2010, the Securities and Exchange Commission issued two releases - [No. 33-9153](#) and [No. 34-63123](#) - setting forth its proposed rules to implement the say-on-pay and say-on-parachute provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act" or the "Act") that we described in detail in our July 19, 2010 client alert: [The Impact of Financial Reform on Executive Compensation](#).

## PROPOSED SAY-ON-PAY RULES

The Dodd-Frank Act, signed into law by President Obama in July 2010, requires public companies to provide shareholders with a non-binding "say-on-pay" vote to approve the compensation of their named executive officers<sup>[1]</sup> at least once every three years and, further, to permit shareholders, at least once every six years, to vote on a non-binding basis as to the frequency of this shareholder vote (i.e., whether the vote will occur every one, two or three years).<sup>[2]</sup>

In Release 33-9153, the SEC proposed new rules and amendments to its existing rules to implement the Act's say-on-pay provisions. These proposed rules require a separate shareholder advisory vote to approve named executive officer compensation in proxy solicitations for each annual or other shareholder meeting for which Item 402 disclosure is required,<sup>[3]</sup> beginning with the first shareholder meeting occurring on or after January 21, 2011 and at least once every three years thereafter.<sup>[4]</sup> No specific form or language is required by the rules, but the vote must pertain to all executive compensation disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis ("CD&A") and the tabular and narrative disclosure.

The SEC clarified that non-employee director compensation is not subject to the say-on-pay advisory vote. In addition, compensation policies and practices that relate to risk management and risk-taking incentives pursuant to 402(s) of Regulation S-K are not subject to the say-on-pay advisory vote; however, a company must disclose such risk considerations in its CD&A to the extent they constitute a material aspect of the company's compensation policies or decisions and, in such case, the risk considerations would be considered by shareholders in their say-on-pay vote.

Although not addressed by the Act, the proposed rules require a company to discuss in its CD&A whether and to what extent it considered the results of previous say-on-pay advisory votes in determining its compensation policies and decisions, and how such considerations affected such policies and decisions.<sup>[5]</sup> As a result, public company compensation committees will likely feel pressured to take actions with respect to their compensation programs consistent with the advisory vote of its shareholders, and where they do not, to provide shareholders with a reasonable justification as to why the company has chosen not to implement the results of the shareholder advisory vote on executive compensation. In addition, the SEC proposed a rule to require companies to disclose in their proxy materials that shareholders are being provided a separate say-on-pay vote, and to briefly explain the general effect of the vote (i.e., whether it is binding or non-binding). Notably, the proposed rules do not require companies to discuss how they might respond to a negative vote, although companies may voluntarily include such a discussion.

Although the Act authorized the SEC to exempt smaller reporting companies from the shareholder compensation approval rules, the SEC chose not to do so, other than to clarify that smaller reporting companies, who are not required to include a CD&A in their proxy materials under current rules, will continue to not be required to do so in order to comply with the proposed rules.

Finally, in order to avoid an unnecessary administrative and cost burden on companies, the proposed rules would include say-on-pay votes, as well as frequency of say-on-pay votes and say-on-parachute votes described below, among the categories for which no preliminary proxy statement is required to be filed.<sup>[6]</sup>

With respect to the say-on-pay rules, the SEC requests comments on or before November 18, 2010, including whether specific language and/or a specific form of resolution should be required to frame the advisory say-on-pay vote for shareholders, whether an exemption from the say-on-pay-vote should be applicable to smaller reporting companies, whether additional disclosures should be provided (and if so, what types), whether the rules will apply in connection with an initial public offering, and whether compliance with the rules warrants a transition period to phase-in the effectiveness of the proposed rules.

## **PROPOSED RULES WITH RESPECT TO THE FREQUENCY OF SAY-ON-PAY VOTES**

As mandated by the Act, the proposed rules require, in proxy solicitations for a company's first shareholder meeting occurring on or after January 21, 2011 and at least once every six years thereafter, a separate, non-binding shareholder vote as to whether the say-on-pay advisory vote will take place every one, two or three years.

Although non-binding, to the extent that the company has implemented a policy as to the frequency of say-on-pay votes that is consistent with the plurality of votes cast in the most recent such vote, the company may exclude a shareholder proposal that would require a say-on-pay vote, seek a future say-on-pay vote, or relate to the frequency of say-on-pay votes, on the grounds that such proposal has been "substantially implemented" within the meaning of Rule 14a-8 of the Exchange Act.

Notably, the proposed rules would require that the proxy card providing a vote on the frequency of say-on-pay votes permit the shareholder to specify by boxes a choice among one, two or three years, or to abstain from voting on the issue. The SEC noted companies must offer these four choices, notwithstanding the general rule that shareholders choose whether to approve, disapprove or abstain from a particular vote. However, the preamble to the proposed rules indicates that the SEC will generally not object if a company is unable to comply in full with this requirement before the final regulations are implemented.[\[7\]](#)

Like the say-on-pay vote described above, the proposed rules require a statement in the proxy disclosure that the company is providing shareholders a separate vote with respect to the frequency of shareholder say-on-pay votes, and the general effect of the vote, and must discuss in the CD&A whether and to what extent the company considered the results of previous shareholder advisory votes.

Under the proposed rules, companies would be required to disclose in their quarterly reports on Form 10-Q, or if the vote occurs during the fourth quarter, in their annual reports on Form 10-K, their decision as to how frequently they will conduct a say-on-pay vote in light of the shareholder advisory vote for the six years subsequent to the meeting. However, the proposed rules do not address how say-on-pay votes are to be counted, nor do they address how companies should treat abstentions.

Notably, as required by the Dodd-Frank Act, companies must comply with the say-on-pay and frequency of vote rules in their proxy statements for their first annual meeting or other meeting of shareholders that occurs on or after January 21, 2011, regardless of whether the proposed rules are adopted by then.[\[8\]](#)

The SEC requests comments on these rules on or before November 18, 2010, including whether specific language and form of resolutions should be designated and required for the frequency vote, whether the four choices available to shareholders are sufficiently clear, whether the plurality standard as proposed is appropriate and whether exclusion of shareholder proposals on frequency should be permitted in the case of a company that materially changes its compensation program during a non-voting year.

## **PROPOSED SAY-ON-PARACHUTE RULES**

### **Generally**

The Dodd-Frank Act provides that, in the proxy materials for a meeting where shareholders are asked to approve an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all of a public company's assets, the proxy must disclose any agreements or understandings with any named executive officer of the company concerning any type of compensation (including deferred and contingent compensation) that is based on or otherwise relates to the transaction, the conditions under which such compensation may be paid or payable, and the aggregate total of all such compensation that may (and the conditions upon which it may) be paid or payable to or on behalf of such officer. The Act provides that the requisite disclosure for these "golden parachute" arrangements be made in a "clear and simple form" in accordance with regulations to be issued by the SEC; however, the Act did not prescribe any particular format for such disclosure.

In Release 33-9153, the proposed rules would amend Schedule 14A to require disclosure in accordance with a new Item 402(t) of Regulation S-K. Under current rules, disclosure of such arrangements is generally required under Item 5 of Schedule 14A to the extent the arrangements would create an interest of an executive officer or director in the transaction; however, Schedule 14A neither requires separate shareholder approval of such arrangements nor prescribes any specific format for such disclosure. As a result, the proposed rules will, for the first time, impose very specific requirements as to the scope and substance of proxy disclosure in connection with a Schedule 14A transaction. In contrast to the say-on-pay and frequency of vote rules being effective for meetings on or after January 21, 2011 regardless of whether the proposed rules have been adopted, the golden parachute provisions will not become effective until the applicable rules are finalized.[\[9\]](#)

Additionally, the SEC broadened the reach of the Act's say-on-parachute provisions to apply the disclosure requirements to other, similar disclosure schedules and forms that are required in connection with similar transactions, such as 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, third-party tender offers on Schedule TO<sup>[10]</sup> and Schedule 14D-9 solicitations, as well as separate proxy solicitations that do not contain merger proposals but require disclosure of information with respect to a merger or similar transaction (such as a solicitation to approve the authorization of additional securities which are to be used to acquire another specified company).<sup>[11]</sup> As noted below, the proposed rules also require disclosure of not only agreements between a named executive officer and a target corporation, but also agreements between an acquiring company and the named executive officers of a target company; however, agreements with an acquiring company are generally not subject to the say-on-parachute advisory vote.

## **Disclosure Requirements**

Proposed Item 402(t) would require disclosure of named executive officers' golden parachute arrangements in both narrative and tabular form but, unlike the Item 402(j) disclosure (regarding post-employment and change in control termination payments), would generally not apply to any individual who would otherwise be a named executive officer but who was not serving as an executive officer at the end of the last completed fiscal year.

With respect to the tabular disclosure, the proposed rules require disclosure of the dollar amount of each of the following elements of compensation: cash severance, accelerated equity awards (or payments in cancellation thereof), pension and non-qualified deferred compensation enhancements, perquisites and other benefits (including health and welfare benefits<sup>[12]</sup>), tax reimbursements and gross-ups, and any other compensation not specifically required by the other columns, as well as a total for each named executive officer.<sup>[13]</sup>

The tabular disclosure in a proxy solicitation to approve a merger or similar corporate transaction requires that the dollar value of the benefit be computed assuming that the triggering event occurred on the latest practicable date and using a stock price per share equal to the closing price on such latest practicable date. If the disclosure is included in a proxy for an annual meeting at which directors are elected (which may be the case if a company wants to have the applicable arrangements deemed to have been subject to a say-on-pay vote for purposes of an exception to the say-on-parachute rules, as described below), the tabular disclosure must be computed assuming that the triggering event took place on the last business day of the company's most recently completed fiscal year, using a stock price per share equal to the closing price on such date. Where reasonable uncertainties exist, companies are directed to make reasonable estimates and to disclose material assumptions underlying such estimates.

Companies must include a footnote quantifying each separate form of compensation included in the aggregate total reported, including the value of all perquisites and other personal benefits (using the aggregate incremental cost method applicable to the summary compensation table) and health care benefits (using the assumptions for financial reporting purposes under generally accepted accounting principles). Furthermore, companies must include footnotes quantifying the amounts that are double-trigger payments, i.e., triggered by a termination within a specified period following a change in control, and those that are single-trigger, i.e., triggered solely by the change in control.

Pursuant to the narrative disclosure requirements of Item 402(t), companies must describe any material factors regarding each golden parachute arrangement, including the specific circumstances that would trigger payment, the form, duration, and person or entity making the payment, and any material conditions or obligations applicable to the receipt of payment (such as restrictive covenants) and the duration and conditions applicable to such conditions.

### **Shareholder Advisory Say-On-Parachute Votes**

Section 951 of the Dodd-Frank Act requires a separate, non-binding say-on-parachute vote on compensation arrangements that are required to be disclosed in connection with mergers and similar transactions. Under the Act, a separate say-on-parachute vote is not required with respect to compensation that was previously subject to a say-on-pay vote, regardless of whether the compensation was approved by the shareholders. However, the preamble to the proposed rules makes clear that in order to be deemed to have been subject to a say-on-pay vote for purposes of this exception, the annual meeting proxy must have included disclosure pursuant to Item 402(t).

As a result, the SEC expects some companies to voluntarily include Item 402(t) disclosure among their other compensation disclosures in proxies for annual meetings, independent of a merger transaction, in order to avail themselves of the exception for a potential subsequent merger; however, under the proposed rules, the exception to the say-on-parachute vote would only be available to the extent that arrangements previously subject to a say-on-pay vote remain unchanged.[\[14\]](#) As a result, all new golden parachute arrangements and any revisions to existing arrangements would be subject to a separate say-on-parachute vote in connection with a future merger, but all such arrangements would be subject to the Item 402(t) disclosure requirements in connection with such merger, calculated as of the most recent practicable date.

In the event of a say-on-parachute vote on new arrangements or revisions to arrangements, companies would be required to include two separate Item 402(t) disclosure tables in their merger proxy statements: one table would disclose all golden parachute compensation, including the new arrangements or revisions, and the second would include only the new arrangements or revisions subject to the vote for the purpose of clarity. In order to give shareholders "the full scope of golden parachute compensation" applicable to a transaction, companies would also be required to disclose golden parachute agreements between an acquiring company and the target's named executives, but such acquirer-target executive arrangements would not be subject to the vote.

The SEC requests comments on these rules on or before November 18, 2010, including whether Item 402(t) disclosure should be required, as proposed, for transactions that are not specifically referenced in the Dodd-Frank Act, and whether certain modifications to golden parachute arrangements should be exempted from being subject to the annual shareholder vote, among others.

## **PROXY VOTE REPORTING RULES**

The shareholder approval provisions of the Act provide that every institutional investment manager subject to Section 13(f) of the Exchange Act<sup>[15]</sup> must report at least annually how it voted on the shareholder say-on-pay, frequency of say-on-pay and say-on-parachute proposals (in the terminology of the release, collectively referred to as "Section 14A Votes"), unless otherwise required to be publicly reported by SEC rule.

Under Release 34-63123, the SEC proposed amendments to Form N-PX (currently adopted under the Investment Company Act) to require institutional investment managers to disclose and file their complete proxy voting records with respect to Section 14A Votes. The proposed rules would require reporting of Section 14A Votes annually, not later than August 31 of each year, for the twelve-month period ended June 30. If no Section 14A Votes occurred during the reporting period, a filing stating that there are no proxy votes to report for the applicable period would be required.

Under these proposed rules, institutional investment managers that exercise "investment discretion" with respect to their own account or the account of any other person holding certain publicly traded equity securities having an aggregate fair market value of at least \$100 million under management on the last trading day in any of the preceding twelve months would be required to file with the SEC how they voted on say-on-pay, say-on-parachute and frequency of say-on-pay advisory votes. However, in a departure from the Form 13F "investment discretion" test, the trigger for disclosure purposes under the Form N-PX is whether, based on facts and circumstances, the institutional investment manager has or shares "voting power" with respect to the Section 14A Vote. The SEC has expressly requested comments on whether the use of "voting power" is appropriate, or whether investment discretion or a different measure should be used.<sup>[16]</sup>

The proposed rules require a range of disclosure items with respect to Section 14A Votes, including the shareholder meeting date, a brief identification of the matter voted on, the number of shares voted, and how those shares were voted (in the case of a proposal, "for or against or abstain"; in the case of the election of directors, "for or withhold") and whether the vote was for or against management's recommendation. The rules permit incorporation by reference to reports filed by another institutional investment manager or management investment company (i.e., a fund) having shared voting power over the shares; however, in some cases, the disclosure obligations of institutional investment managers will differ from those of funds, such as a requirement that funds, but not institutional investment managers, disclose whether a matter was proposed by the issuer or security holder.

Release 34-63123 states that the SEC intends that Form N-PX filings will be publicly available through EDGAR, but notes that under "narrowly circumscribed circumstances" confidential treatment may be appropriate, such as when a confidential treatment request for information reported on Form 13F is pending or has been granted.

Comments on the proposed rules are requested on or before November 18, 2010. If adopted, the proposed rules would require institutional investment managers to file their first reports under the proposed rules with respect to Section 14A Votes at shareholder meetings between January 21, 2011 and June 30, 2011, with the filing due by August 31, 2011.

[\[1\]](#) Under Item 402 of Regulation S-K of the Securities Act of 1933, a company's "named executive officers" include its chief executive officer, its chief financial officer, its three most highly compensated executive officers (other than the CFO and CEO) who were serving as of the end of the last completed fiscal year, and up to two additional individuals with respect to whom disclosure would have been required but for the fact that the individuals were not serving as executive officers as of the end of the last completed fiscal year.

[2] The Act also amends the Exchange Act by prohibiting brokers from voting brokerage account shares in connection with the election of directors, executive compensation or any "other significant matter" unless the broker has received specific instructions from the beneficial owner of the shares as to how to vote. In Release 33-9153, the SEC noted that the national securities exchanges have begun amending their rules in order to comply with the prohibition of broker discretionary voting on executive compensation matters, but the SEC did not issue any new rules with respect to the issue.

[3] Item 402 disclosure is generally required to be included in annual reports to shareholders and proxy and information statements under Section 14 of the Exchange Act, including proxies in connection with the election of directors, tender offers, going-private transactions and shareholder approval of new equity compensation plans.

[4] With respect to companies with outstanding indebtedness under the Troubled Asset Relief Program ("TARP"), the say-on-pay rules will only be required for proxies with respect to the first annual meeting occurring on or after repayment of all indebtedness and at least once every three years thereafter, because TARP companies are already subject to annual shareholder say-on-pay votes pursuant to the Emergency Economic Stabilization Act of 2008 while their repayment obligations are outstanding.

[5] Unless a company has conducted at least one prior say-on-pay advisory vote, this requirement will not be applicable for 2011 proxy filings.

[6] Currently, Exchange Act Rule 14a-6 requires companies to file preliminary proxy statements at least ten days before they are sent to shareholders, unless the items to be voted upon include only certain specified matters, including the election of directors, the approval of equity compensation plans, the ratification of accountants and the shareholder advisory votes with respect to TARP recipients with outstanding repayment obligations.

[7] The SEC recognizes that some proxy service providers will have difficulty enabling their systems to provide for four votes (one, two, three years or abstention) instead of the current configuration that provides for three (approval, disapproval or abstention) pursuant to Rule 14a-4. Therefore, if a company presents shareholders with boxes marked 1, 2 and 3 and does not count a vote for a shareholder who fails to select a choice among those three options, the SEC indicated that it will not object.

[8] However, with respect to TARP recipients already subject to annual say-on-pay votes during the period in which they have outstanding repayment obligations, the frequency votes are only required for the first annual meeting occurring on or after repayment and at least once every six years thereafter.

[9] A calendar of proposed rulemaking issued by the SEC indicated that final say-on-pay rules would be expected in the first quarter of 2011.

[10] The proposed rules would require the bidder in a third-party tender offer to provide information in its Schedule TO about a target's golden parachute arrangements only to the extent the bidder has knowledge of such arrangements.

[11] However, the proposed rules would not apply to agreements and understandings with senior management of foreign private issuers where the target or subject company is a foreign private issuer, or to both bidders and targets in third-party tender offers and filing persons in going-private transactions where the target or subject company is a foreign private issuer.

[12] Unlike Item 402(j), inclusion is required even if the benefits are not discriminatory in scope, terms or operation in favor of executive officers or directors of the company and are generally available to all salaried employees. Additionally, Item 402(t) does not provide exclusion for a named executive officer's perquisites and other personal benefits to the extent the total value of such benefits is less than \$10,000.

[\[13\]](#) Notably, Item 402(t), like Item 402(j), focuses on the incremental benefits of a transaction; the proposed rules would not require separate disclosure or quantification with respect to compensation disclosed in the pension and/or deferred compensation tables, nor would it require disclosure or quantification of previously vested equity awards or disclosure of compensation from bona fide post-transaction employment agreements in connection with the transaction.

[\[14\]](#) As noted above, to the extent a company voluntarily includes Item 402(t) disclosure in its annual proxy statement, the quantitative disclosure would be calculated based on the last day of the most recently completed fiscal year.

[\[15\]](#) Institutional investment managers file quarterly securities holdings reports on Form 13F to the extent that they exercise "investment discretion" with respect to accounts holding certain equity securities having an aggregate fair market value of \$100 million or more. Under Section 3(a)(35) of the Exchange Act, "investment discretion" with respect to an account generally means the authority to determine what securities or other property will be purchased or sold, or to make decisions regarding or exercise influence with respect to such purchases and sales. This determination is made upon a facts and circumstances analysis.

[\[16\]](#) The SEC noted that under the proposed rules discrepancies between the Form 13F filings and Form N-PX filings might occur where, for example, an institutional investment manager exercises investment discretion with respect to a security held in a client's account, but the client retained all rights to vote proxies in respect of that security. In such a case, the Form 13F would report the security to the extent held at quarter's end, but the Form N-PX would not.

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