

SEC Adopts Rules on Say-On-Pay and Say-On-Golden Parachutes

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Client Advisory

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On January 25, 2011, the SEC adopted final rules implementing Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act that require U.S. public companies to conduct separate shareholder advisory votes on:

- executive pay ("say-on-pay")
- frequency of the vote on say-on-pay ("say-on-frequency"); and
- executive compensation in connection with mergers and acquisitions ("M&A") transactions that are submitted to shareholders for approval ("say-on-golden parachutes").

Say-on-Pay

Under new Rule 14a-21(a), issuers must provide shareholders with a separate advisory (i.e. non-binding) vote in proxy statements to approve the compensation of their named executive officers at least once every three years.

Say-on-Pay (and say-on-frequency votes), are required only for annual meetings of shareholders in which proxies are being solicited to elect directors or a special meeting in lieu thereof.

The say-on-pay vote:

- covers all of Compensation Discussion and Analysis (CD&A), the compensation tables and the narrative compensation discussion provided under Regulation S-K Item 402;
- does not cover director compensation; and
- does not cover disclosure under Regulation S-K Item 402(s), related to compensation policies and practices for employees that are reasonably likely to have an adverse material effect on the company. But, if risks arising from compensation policies are discussed as part of CD&A, that discussion will be covered by the say-on-pay vote, because it is part of the CD&A disclosure.)

While the final rules do not require specific language or form for the say-on-pay resolution, a company must indicate that the say-on-pay vote is a vote to approve all executive compensation disclosed pursuant to Item 402 of Regulation S-K.^[1]

The SEC also adopted amendments to require issuers to address in the 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. It is the SEC's view that companies must use CD&A to address their consideration of earlier say-on-pay votes to the extent such consideration is material to a company's compensation policies and decisions. Smaller reporting companies would not be subject to this requirement, but they are already required to provide a narrative description of material factors necessary to understand the summary compensation table, and therefore would need to disclose the affect of prior say-on-pay votes if that is a material factor in setting compensation. This requirement is for disclosure only and does not require a board to conform to a vote on say-on-pay.

Say-on-Frequency

Under new Rule 14a-21(b), issuers are required, at least once every six calendar years, to provide shareholders with a separate advisory (i.e. non-binding) vote in proxy statements to determine whether the say-on-pay vote will occur every one, two, or three years. Frequency votes are required only for annual meetings of shareholders in which proxies are solicited to elect directors or a special meeting in lieu thereof.

Shareholders must be given four choices, i.e., voting for the say-on-pay vote should occur every one, two, or three years, or abstaining from voting on the matter. While the company's board of directors may include a recommendation as to how shareholders should vote on the frequency of the say-on-pay vote, the company must make clear that all four choices are available and that the shareholders are not voting to approve or disapprove the board's recommendation^[2]

Companies may vote uninstructed proxy cards in favor of the board's say-on-frequency recommendation, but only if:

- a. the proxy describes the board's recommendation;
- b. the company is presenting all four options (1, 2 or 3 years or abstain); and
- c. bold language on the proxy card advises stockholders how uninstructed shares will be voted.

Companies must disclose their decisions as to how often they will hold say-on-pay votes going forward either in the Form 8-K disclosing their annual meeting voting results or in an amendment to that Form 8-K. If companies choose the amendment to the Form 8-K, it must be filed no later than 150 calendar days following their annual meetings and at least 60 calendar days before their deadlines for submission of shareholder proposals. Missing the filing deadline for this Item 5.07 of Form 8-K will cause issuers to lose their eligibility to file Form S-3 registration statements (absent a subsequent waiver from the SEC Staff).

Rules Related to Both Say-On-Pay and Say-on-Frequency

Under new Item 24 of Schedule 14A, a company must (i) disclose that it is providing a separate shareholder vote on executive compensation and on the frequency of the executive compensation vote in the proxy statement for those votes, (ii) briefly explain the general effect of the votes, such as that the votes are non-binding, and (iii) disclose the current frequency of company's say-on-pay vote and when the next say-on-pay vote will be conducted.

Certain Shareholder Proposals May Be Excluded as Substantially Implemented

An amendment to Rule 14a-8(i)(10) allows companies to exclude a shareholder proposal that would provide a say-on-pay or say-on-frequency vote, provided the issuer has adopted a policy on frequency that is consistent with the choice of a majority of votes cast in the most recent say-on-frequency vote. Abstentions do not count.

Preliminary Proxy Not Required

Amended Rule 14a-6 now states that a preliminary proxy statement is not required for shareholder advisory votes on executive compensation (including shareholder votes on say-on-pay and say-on-frequency).

IPOs and Smaller Reporting Companies

IPO companies have been given no exemption from the new rules.

Smaller reporting companies need not propose say-on-pay and say-on-frequency votes until stockholder meetings occurring on or after January 21, 2013. New CDIs 169.01-169.03 provide specific transition guidance for companies entering and exiting smaller reporting company status.

Say-on-Golden Parachutes

Under the new rules, issuers must comply with requirements for disclosure of golden parachute arrangements and requirement for a separate shareholder advisory vote to approve golden parachute arrangements. Under new Rule 14a-21(c) in any proxy or consent solicitation for a meeting at which shareholders are asked to approve an M&A transaction companies must provide a separate shareholder advisory vote to approve the golden parachute payments disclosed under new Item 402(t) of Regulation S-K, described below. An M&A transaction covered by the new rules is any acquisition, merger, consolidation or proposed sale or disposition of all or substantially all of an issuer's assets.

The SEC adopted Item 402(t) of Regulation S-K, which requires disclosure of the golden parachute arrangements of named executive officers in both tabular and narrative formats. "Golden parachutes" are broadly defined so that disclosure is required for all agreements or understandings between the named executive officers and either the acquiring company or the target company related to the applicable M&A transaction. The disclosure is required in both tabular and narrative forms, must include all arrangements and without any de minimis exception.

The table should present, in a series of columns for each named executive officer, the dollar value of all golden parachute payments potentially payable in connection with the transaction. The table should include columns for the dollar value of: cash severance; equity awards that are accelerated or otherwise cashed out; pension and non-qualified deferred compensation enhancements; perquisites and other personal and health and welfare benefits; tax reimbursements; other compensation; and the total amount of all such compensation.

Each individual element of compensation is required to be quantified separately in footnote disclosure. For example, base salary, bonus, and non-equity long-term incentive plan compensation components of the aggregate cash amount should all be listed in a footnote. Additionally, footnote disclosure is required to identify which amounts are attributable to "single trigger" arrangements (i.e., triggered solely by the transaction) and which are attributable to "double trigger" arrangements (i.e., triggered by a termination or resignation within a specified time after the transaction). Item 402(t) also requires narrative disclosure of any material conditions or obligations applicable to the receipt of golden parachute payments (e.g. a non-compete or non-solicit obligation).

Golden parachutes do not include certain types of compensation that are deemed not related to the transaction, such as previously vested equity awards, deferred compensation and compensation from bona fide post-transaction employment agreements.

If the target company is the soliciting person, then agreements or understandings between the acquirer and the named executive officers of the target, while required to be disclosed, are not subject to the say-on-golden parachute vote.

Companies are not required to conduct say-on-golden parachute votes if the golden parachute arrangements were already voted upon in an annual say-on-pay vote and have not been modified. Changes to golden parachute arrangements that decrease the total compensation do not require a subsequent shareholder vote. There is little advantage to including the necessary enhanced golden parachute disclosure in an annual proxy statement.

Golden parachute votes are only required in transactional filings where shareholders are being asked to approve the transaction, and not where the shareholders vote on a related issue, such as a vote to increase the number of authorized shares or issue more than 20% of the share outstanding to facilitate a merger.

The SEC amended the disclosure requirements of SEC forms other than proxy statements to require golden parachute payment disclosure in other business combination transactions, such as tender offers, going-private transactions, or transactions involving an information statement not subject to Regulation 14A. However, bidders in third-party tender offers are not required to provide golden parachute disclosure on Schedule TO if the third-party tender offer is not also a Rule 13e-3 going-private transaction.

Item 402(t) disclosure will be required in essentially all documents that relate to a business combination, including:

- 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 (for example, proxies solicited to approve the issuance of new shares or a reverse stock split in order to conduct a merger transaction);
- Registration statements on Forms S-4 and F-4 (that do not otherwise contain certain proxy statement disclosure) containing disclosure relating to mergers and similar transactions;
- going private transactions statements on Schedule 13E-3; and
- Schedule 14D-9 solicitation/recommendation statements.

Shareholder approval, however, would not be required in connection with these additional disclosure requirements.

Companies Covered by the New Rules

The new rules apply to all companies that are subject to the proxy solicitation requirements of the Exchange Act, including all domestic issuers. Foreign private issuers will generally not be subject to the new rules.

Effective Date

While the say-on-pay and say-on-frequency rules will not technically be effective until April 4, 2011, implementation by public companies (other than smaller reporting companies) will occur immediately as the Dodd-Frank Act already requires those companies to hold say-on-pay and say-on-frequency votes at the company's first shareholder meetings held on or after January 21, 2011. Smaller reporting companies are not required to comply with the say-on-pay and say-on-frequency rules until their first annual shareholder meeting on or after January 21, 2013.

The new disclosure and voting requirements for golden parachutes will apply to initial filings of the applicable statements and schedules by issuers (including smaller reporting companies) made on or after April 25, 2011.

Questions regarding this advisory should be addressed to **Guy P. Lander** (212-238-8619, lander@clm.com) or **Steven J. Glusband** (212-238-8605, glusband@clm.com).

Endnotes

[1] The final rules provide the following example: “RESOLVED, that the compensation paid to the companies 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”.

New CDI 169.05 permits issuers to substitute plain English wording for “pursuant to Item 402 of Regulation S-K” in this sample resolution, such as:

“pursuant to the compensation disclosure rules of the Securities and Exchange Commission, including the compensation discussion and analysis, the compensation tables and any related material disclosed in this proxy statement.”

[2] The final rules do not prescribe a form of resolution for the say-on-frequency vote, and the new CDI 169.04 clarifies that no formal resolution need be proposed at all. New CDI 169.06 also provides flexibility for the wording of the vote, allowing it to include the words “every year, every other year, or every three years, or abstain” instead of the words, “every 1, 2, or 3 years, or abstain.”

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