The SEC Proposes Rules on Shareholder Approval of Executive and Golden Parachute Compensation and on Reporting of Proxy Votes on Executive Compensation

On October 18, 2010, the Securities and Exchange Commissions ("SEC") issued two proposed rules called for by Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[1] The first of these proposals requires two separate shareholder advisory votes: one to approve executive compensation (a "say-on-pay" vote), and a second to determine the frequency of advisory votes on executive compensation.[2] This proposal further requires disclosure of compensation arrangements in proxy or consent solicitations in connection with merger transactions (known as "golden parachute" arrangements) and in some cases, a separate shareholder advisory vote to approve these arrangements.

The SEC's second proposal requires institutional investment managers subject to Section 13(f) of the Securities Exchange Act of 1934 ("Exchange Act") to report annually how they voted on executive compensation matters.[3] If these proposed rules are adopted, they will take effect with an issuer's first annual or other meeting of shareholders occurring on or after January 21, 2011.

The SEC is seeking comment on its proposed rules through November 18, 2010.

I. Shareholder Approval of Executive and "Golden Parachute" Compensation

The SEC's proposal on shareholder approval of executive compensation and "golden parachute" compensation arrangements is intended to implement the requirements of Section 14A of the Exchange Act, which was recently added by Section 951 of the Dodd-Frank Act.

A. Shareholder Approval of Executive Compensation[4]

At the core of the SEC's proposed rule regarding executive compensation is the requirement that issuers provide a separate shareholder advisory vote in proxy statements to approve the compensation of its named executives, no less frequently than once every three years. Such a shareholder vote would only be required when proxies are solicited for an annual meeting or other shareholder meeting for which the rules require disclosure of executive compensation per Item 402 of Regulation S-K. While no specific language or form of resolution would be required under the proposed rule, the shareholder vote would have to "relate to all executive compensation

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1 The Dodd-Frank Act is available at http://www.govtrack.us/congress/billtext.xpd?bill=h111-4173.

2 *See Shareholder Approval of Executive Compensation and Golden Parachute Compensation*, Release Nos. 33-9153, 34-63124; File No. S7-31-10 (Oct. 18, 2010), available at http://www.sec.gov/rules/proposed/2010/33-9153.pdf.

3 *See Reporting of Proxy Votes on Executive Compensation and Other Matters*, Release Nos. 34-63123, IC-29463; File No. S7-30-10 (Oct. 18, 2010), available at http://www.sec.gov/rules/proposed/2010/34-63123.pdf.

4 Because all issuers would be required to solicit votes on executive compensation and the frequency of votes on executive compensation, the SEC is proposing to amend Rule 14a-6(a) to add shareholder votes on these two matters to the list of items that do not trigger a preliminary filing of a proxy statement prior to its being sent to shareholders. *Shareholder Approval of Executive Compensation and Golden Parachute Compensation*, at 31.

disclosure set forth pursuant to Item 402 of Regulation S-K" in order to satisfy the proposed rule's advisory vote requirement.[5]

The shareholder advisory vote on executive compensation is not required to be binding. In a proxy statement for the annual or other shareholder meeting, issuers would be obligated to disclose that they are providing a separate shareholder vote on executive compensation and to state whether the vote is non-binding. Furthermore, in an attempt to "facilitate better investor understanding of issuers' compensation decisions," the SEC proposes to amend Item 402(b) of Regulation S-K to require issuers to address, in the 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."[6] Smaller reporting companies, who are not required to provide a CD&A, would not be subject to this requirement; however, in preparing a narrative description of material factors necessary for understanding the information in their Summary Compensation Table, these companies would be required to include, if it is indeed a material factor, consideration of prior executive compensation advisory votes.[7]

B. Shareholder Approval of Frequency of Votes on Executive Compensation

The SEC proposes that "issuers would be required, not less frequently than once every six years, to provide a separate shareholder advisory vote in proxy statements for annual meetings to determine whether the shareholder vote on the compensation of executives . . . 'will occur every 1, 2, or 3 years.'"[8] Like the advisory vote on executive compensation, the vote on the frequency of such votes is proposed to be required only in a proxy statement for an annual meeting or another shareholder meeting for which compensation disclosure is mandated.

Pursuant to the SEC's proposal, shareholders must be given four choices with regard to the frequency vote: "whether the shareholder vote on executive compensation will occur every 1, 2, or 3 years, or to abstain from voting on the matter."[9] The proxy statement may include the recommendation of the board of directors, but must make clear that the shareholders have four choices and that they are not voting for or against the recommendation.

The SEC believes that the frequency vote, like the vote on executive compensation, need not be binding. Under the proposed rule, issuers would need "to disclose in the proxy statement that they are providing a separate shareholder advisory vote on the frequency of the shareholder vote on executive compensation" and "to briefly explain the general effect of this vote, such as whether the vote is non-binding."[10] The SEC proposes to amend Forms 10-Q and 10-K (for shareholder meetings taking place during the fourth quarter) to reflect the issuer's

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5 *Shareholder Approval of Executive Compensation and Golden Parachute Compensation*, at 13.

6 *Id*. at 16.

7 Smaller reporting companies are generally companies with a public float of less than $75 million as of the last day of their most recently completed second fiscal quarter. See Exchange Act Rule 12b-2.

8 *Id*. at 19 (quoting Exchange Act § 14A(a)(2)).

9 *Id*. at 21.

10 *Id*.

ultimate decision on whether the frequency of the advisory vote on executive compensation will follow the results of the shareholder vote. Additionally, for those issuers who implement the results of the advisory vote on frequency, the SEC proposes "to permit the exclusion [from an issuer's proxy materials] of a shareholder proposal that would provide a say-on-pay vote or seeks future say-on-pay votes or that relates to the frequency of say-on-pay votes."[11]

C. Disclosure and Shareholder Approval of "Golden Parachute" Arrangements

In addition to shareholder advisory votes on executive compensation and on the frequency with which such votes should take place, the SEC proposes to introduce detailed disclosure requirements "with respect to golden parachute compensation arrangements in proxy or consent solicitations in connection with an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all assets."[12] While the SEC's existing rules already require general disclosure about "golden parachute" arrangements, they do not include detailed requirements for such disclosures that are applicable to proxy or consent solicitations to approve the transaction.

Under the SEC's proposal, disclosure of named executive officers' "golden parachute" arrangements would need to be disclosed in both tabular and narrative formats. The tabular disclosure would require quantification of every type of compensation (whether present, deferred, or contingent) pursuant to any agreement (whether written or unwritten) that is based on or connected to the transaction. The table would "present quantitative disclosure of the individual elements of compensation that an executive would receive that are based on or otherwise relate to the merger, acquisition, or similar transaction," including "cash severance, equity awards that are accelerated or cashed out, pension and nonqualified deferred compensation enhancements, perquisites, and tax reimbursements," as well as any other compensation related to the transaction.[13] In addition, the table would provide the aggregate total compensation for each named executive officer. The narrative disclosure would describe "any material conditions or obligations applicable to the receipt of payment, . . . 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."[14]

The proposed amendments with regard to disclosure of "golden parachute" arrangements would require disclosure not only in proxy or consent solicitation materials seeking shareholder approval of the relevant transaction, but also 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, 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.[15] Thus, in order to maintain regulatory consistency across the different

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11 *Id*. at 24.

12 *Id*. at 38.

13 *Id*. at 41, 45.

14 *Id*. at 46.

15 *Id*. at 52-53.

types of transactions, disclosure requirements in connection with "golden parachute" arrangements are equally applicable to going private transactions and tender offers as to acquisitions and mergers.

Proxy or consent solicitation for meetings at which shareholders are asked to approve an acquisition, merger, consolidation, or sale of the issuer's assets must not only contain the requisite disclosures with regard to "golden parachute" arrangements, but must also provide a separate shareholder advisory (non-binding) vote with respect to such arrangements "between the soliciting person and any named executive officer of the issuer or any named executive officers of the acquiring issuer, if the soliciting person is not the acquiring issuer."[16] The shareholder vote on "golden parachute" compensation would not be required, however, where disclosure of such compensation was included in the executive compensation disclosure previously subject to a shareholder advisory vote. This exception would apply only to the extent that the same "golden parachute" arrangements previously disclosed and subject to a shareholder vote remain in effect; any revisions or new "golden parachute" arrangements would be subject to the merger proxy shareholder vote requirement, in which case issuers would need to include one table disclosing all "golden parachute" compensation (including those previously disclosed and subject to a say-on-pay vote), and one table disclosing only the new arrangements or revised terms, such that shareholders could discern what is being voted upon.

II. Reporting of Proxy Votes on Executive Compensation

In a companion release to the release summarized above, the SEC proposes amendments that would require institutional investment managers that are required to file reports under Section 13(f) of the Exchange Act "to report annually how [they] voted proxies relating to executive compensation matters as required by Section 14A" of the Exchange Act.[17] Thus, a person is subject to this new reporting requirement if the person is both an institutional investment manager as defined in Section 13(f)(6)(A) of the Exchange Act and is required to file reports under Section 13(f) of the Exchange Act. An "institutional investment manager," pursuant to Section 13(f)(6)(A) of the Exchange Act, includes "any person, other than a natural person, investing in or buying and selling securities for its own account, and any person exercising investment discretion with respect to the account of any other person."[18] An institutional investment manager must file reports under Section 13(f) if the manager "exercises investment discretion with respect to accounts holding Section 13(f) securities having an aggregate fair market value on the last trading day of any month of any calendar year of at least $100 million."[19] Institutional investment managers who satisfy these criteria are already obligated to file quarterly Form 13F reports, disclosing their Section 13(f) securities; pursuant to the SEC's proposal, these institutional investment managers would be required to report their proxy voting record on compensation-related items as well.

Institutional investment managers would be required to report their votes on the approval of executive compensation, the frequency of executive compensation approval votes, and the approval of "golden parachute" compensation arrangements (collectively, "Section 14A Votes"). This reporting requirement would apply in cases in which the institutional investment manager, either directly or indirectly, had or shared the power to vote

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16 *Id*. at 56.

17 *Reporting of Proxy Votes on Executive Compensation and Other Matters*, at 1.

18 *Id*. at 8 (quoting Exchange Act § 13(f)(6)(A)).

19 *Id*. at 8-9.

in compensation-related matters. The SEC's proposal would require an institutional investment manager to report its votes with respect to "any security" with respect to which it has voting power. The SEC suggests that institutional investment managers be required "to report their Section 14A Votes annually on Form N-PX not later than August 31 of each year, for the most recent twelve-month period ended June 30," which would conveniently coincide with the "schedule on which funds are required to report their complete proxy voting records on Form N-PX."[20]

The SEC proposes "amendments to Form N-PX that would permit (1) a single institutional investment manager to report Section 14A Votes in cases where multiple institutional investment managers share voting power; and (2) an institutional investment manager to satisfy its reporting obligations by reference to the Form N-PX report of a fund that includes the manager's Section 14A Votes."[21] In either case, the non-reporting manager would need to file a Form N-PX report identifying each institutional investment manager and/or fund reporting on its behalf. Conversely, funds as well as institutional investment managers filing reports of Section 14A Votes subject to shared voting power would be obligated to list the managers on behalf of whom the filing is made.

Additionally, the SEC envisions Form N-PX to be amended to consist of a Cover Page, Summary Page, and required proxy voting information. The Cover Page would include a new section to be used where the filing is an amendment to a prior Form N-PX report, and would require the reporting person to identify the report as a registered management investment company report, an institutional investment manager "voting" report (which contains all Section 14A Votes of the manager), an institutional investment manager "notice" report (which does not contain any Section 14A Votes of the manager, since all such votes are reported by other institutional investment managers or funds), or an institutional investment manager "combination" report (in which some Section 14A Votes of the manager are reported but others are reported by other institutional investment managers or funds). Where some or all of the manager's Section 14A Votes are reported by other institutional investment managers or funds, the manager must list the file numbers and names of the other institutional investment managers or funds whose Form N-PX reports include that manager's Section 14A Votes. The Summary Page of Form N-PX, which would need to be included in any report filed by a fund and any report of an institutional investment manager other than a "notice" report, would need to state the number of and list the institutional investment managers whose Section 14A Votes are included in the report. Finally, the SEC proposes that each institutional investment manager disclose, in a standardized order on its Form N-PX, information relevant to each Section 14A Vote with respect to which the manager had voting power, such as the name of the issuer, exchange ticker symbol, and Council on Uniform Securities Identification Procedures ("CUSIP") number of the security, the shareholder meeting date, the matter voted upon, the number of shares over which the reporting person had voting power, the number of shares that were voted, and how the reporting person voted. Furthermore, where a reporting person is reporting on behalf of other institutional investment managers, the reporting person would be required to identify each institutional manager on behalf of whom the Form N-PX report is being filed.

While the information contained on Form N-PX would be publicly available, the SEC envisions a narrow circumstance in which a request for confidential treatment might be appropriate: "where an institutional investment manager has filed a confidential treatment request for information reported on Form 13F that is

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20 *Id*. at 15.

21 *Id*. at 20.

pending or has been granted and where confidential treatment of information filed on Form N-PX would be appropriate in order to protect information that is the subject of the Form 13F confidential treatment request."[22]

Assuming the proposed rules are adopted, the SEC would require institutional investment managers to file their first Form N-PX reports for Section 14A Votes taking place on meetings held on or after January 21, 2011, and ending on June 30, 2011. The due date for the filings would be August 31, 2011.

III. Conclusion

If adopted, the SEC's proposed rules, which would implement the new Section 14A of the Exchange Act, would provide issuers with detailed guidance with regard to the requisite disclosures and shareholder votes pertaining to executive compensation and "golden parachute" compensation arrangements, and would clarify the reporting obligations of institutional investment managers and funds with regard to their Section 14A Votes. In line with the spirit of the Dodd-Frank Act, the proposed rules, if adopted, would increase transparency with regard to executive and "golden parachute" compensation and would require the participation of shareholders in the approval of such compensation.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or Yafit Cohn at 212.701.3089 or ycohn@cahill.com.

[22] *Id*. at 38.