SEC Adopts Final Rules Regarding Shareholder Approval of Executive and Golden Parachute Compensation

On January 25, 2011, the Securities and Exchange Commission ("SEC") adopted final rules concerning shareholder advisory votes on

(i) executive compensation ("say-on-pay"),

(ii) the frequency of conducting say-on-pay votes ("say-on-frequency"), and

(iii) compensation arrangements in connection with significant corporate transactions ("say-on-golden-parachutes").[1]

These rules implement Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"),[2] and they apply to all public companies that have a class of equity securities registered under Section 12 of the Securities Exchange Act of 1934 ("Exchange Act") and that are subject to the federal proxy rules.[3] The new rules become effective 60 days after publication in the Federal Register.[4]

I. Shareholder Approval of Executive Compensation ("Say-On-Pay")

The SEC's new rules require public companies to afford shareholders the opportunity to cast a non-binding advisory vote, at least once every three calendar years, on the executive compensation information disclosed in their annual proxy statements for their named executive officers ("NEOs"), pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis ("CD&A"), the compensation tables and the other narrative compensation disclosures.[5] Companies must disclose in their annual proxy statements that the vote is being sought pursuant to the Exchange Act, its general effect and the fact that it is non-binding.[6] Commencing in 2012, companies must also disclose in the CD&A section of the proxy statement whether they

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[1] *See Shareholder Approval of Executive Compensation and Golden Parachute Compensation*, Release Nos. 33-9178; 34-63768; File No. S7-31-10 (Jan. 25, 2011), *available at* http://www.sec.gov/rules/final/2011/33-9178.pdf.

[2] The Dodd-Frank Act is available at http://www.govtrack.us/congress/billtext.xpd?bill=h111-4173. Section 951 of the Dodd-Frank Act added Section 14A to the Exchange Act. Section 14A requires companies to conduct separate shareholder advisory votes regarding "say-on-pay," "say-on-frequency," and "say-on-golden-parachutes."

[3] Pursuant to the new rules, smaller reporting companies (*i.e.*, those with a public float of less than $75 million) are not required to conduct say-on-pay and say-on-frequency votes until annual meetings occurring on or after January 21, 2013. In addition, companies that conduct an annual shareholder vote to approve executive compensation under the Troubled Asset Relief Program ("TARP") are not required to comply with the new say-on-pay and say-on-frequency rules until the first annual shareholders meeting after repayment of all outstanding indebtedness under TARP.

[4] Pursuant to the Dodd-Frank Act, however, companies are required to hold say-on-pay and say-on-frequency votes at the first annual shareholders meeting taking place on or after January 21, 2011. Despite the fact that the new rules are not currently effective, they can provide guidance to companies regarding appropriate proxy statement disclosures.

[5] Although the final rules provide that the say-on-pay vote does not encompass any disclosure required under Item 402(s) of Regulation S-K regarding risks arising from a company's employee compensation programs, it would encompass any disclosure included in the CD&A regarding risks resulting from compensation programs for the NEOs.

[6] Companies are not required to file preliminary proxy statements if the only matters that would require such a filing are the say-on-pay or say-on-frequency votes.

have considered the results of the most recent say-on-pay vote, and if so, how that consideration affected the company's decisions and policies regarding executive compensation.

Although the new rules do not require the use of any specific language or form of resolution to be used in the proxy statement, the SEC provided a non-exclusive example of a resolution that would be deemed to comply with the new rules. The illustrative resolution reads:

> "RESOLVED, that the compensation paid to the company's 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."

II. Shareholder Approval of Frequency of Votes on Executive Compensation ("Say-On-Frequency")

The new rules also require a company to provide shareholders with a separate, non-binding advisory vote on how often the company should conduct say-on-pay votes. A company must disclose in its annual proxy statements that the vote is being sought pursuant to provisions of the Exchange Act, the general effect of the vote and the fact that it is non-binding. In the proxy solicitation, a company must provide shareholders with proxy cards containing four options with respect to a frequency vote—one year, two years, three years or abstain.[7] Although a company's board of directors may make a recommendation regarding the frequency of say-on-pay votes, the proxy disclosure must clearly explain to shareholders that they have four choices and are not voting to approve or disapprove the board's recommendation.[8]

Pursuant to the final rules, a company may vote signed but uninstructed proxy cards in accordance with management's recommendation for the say-on-frequency vote, but only if the company (i) includes a recommendation for the say-on-frequency vote in the proxy statement, (ii) permits abstention on the proxy card, and (iii) includes boldface language on the proxy card stating how uninstructed shares will be voted.

In addition, the new rules permit companies to exclude shareholder proposals seeking a say-on-pay or say-on-frequency vote, including those proposals drafted as requests to amend corporate governing documents, if (i) a majority of votes were cast with respect to a particular frequency in the most recent say-on-frequency vote, and (ii) the company adopts the frequency policy that is consistent with the frequency that received a majority of votes cast.[9] The "majority" exclusionary threshold is a change from the "plurality" standard set forth in the rules as proposed in October 2010.

The say-on-frequency vote must take place at least once every six calendar years. Companies must disclose the frequency of the say-on-pay vote in their annual proxy statements and state when the next such vote will occur.[10] In addition, companies must disclose their decisions regarding how frequently they will hold a say-on-pay vote in light of the results of the say-on-frequency vote. Such disclosure must be made on the Form 8-K

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[7] If proxy service providers are unable to immediately reprogram their systems to provide four voting choices, the SEC stated that it will not object if the form of proxy provides only three choices (one, two or three years) with respect to meetings which are to be held on or before December 31, 2011.

[8] The final rules create an exception to Exchange Act Rule 14a-4, which currently provides that proposals (other than the election of directors) may be structured only as for, against or abstention votes.

[9] For purposes of this analysis, an abstention would not count as a vote cast.

[10] This disclosure is not required in a company's first year of conducting say-on-pay and say-on-frequency votes.

required to report the results of the say-on-pay vote, or an amendment to that Form 8-K which should be filed no later than 150 calendar days after the date of the meeting at which the say-on-frequency vote was held, but in no event later than 60 calendar days prior to the deadline for submission of shareholder proposals for the subsequent annual meeting.[11]

III. Disclosure and Shareholder Approval of "Golden Parachute" Arrangements ("Say-On-Golden-Parachutes")

The new rules also create a new Item 402(t) of Regulation S-K. Pursuant to paragraph (t), in connection with shareholder meetings at which shareholders are asked to approve a merger, acquisition, consolidation, proposed sale or disposition of all or substantially all assets, and in connection with going private transactions and third party tender offers, a company must provide narrative and tabular disclosure of all related compensation arrangements with the NEOs ("golden parachutes").[12] The disclosure requirements of Item 402(t) are different from, and more extensive than, the disclosure requirements currently required under Item 402(j) of Regulation S-K, regarding potential payments upon a termination of employment of the executives or a change-in-control of the company. Pursuant to Item 402(t), a company must provide tabular disclosure that quantifies each NEO's:

- Cash severance payment;
- Accelerated stock awards, accelerated vesting option awards and payments made in cancellation of stock and option awards;
- Pension and nonqualified deferred compensation benefit enhancements;
- Perquisites, other personal benefits and health and welfare benefits;
- Tax reimbursements (*e.g.*, tax gross-ups);
- Any other elements of compensation; and
- The aggregate of all such compensation.

A copy of the format for this new table is included as Exhibit A to this memorandum.

A company may also insert information for other NEOs and include additional rows or columns in the table to make it clearer, so long as such disclosure is not misleading. In addition, the new rules require the use of footnotes regarding which payment amounts in the table are triggered merely by the occurrence of a change-in-control (*i.e.*, "single-trigger" arrangements) and which are contingent upon a qualifying termination of employment (*i.e.*, a termination of the employee without "cause" or a termination by the employee with "good reason") within a certain time-frame of the change-in-control (*i.e.*, "double-trigger" arrangements). Pursuant to Item 402(t), a company is only required to disclose golden parachute compensation that is based on or otherwise relates to the subject transaction; a company is not required to disclose or quantify amounts of previously vested

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[11] As originally proposed in October 2010, the rules would have required a company to make this disclosure on a Form 10-Q or a Form 10-K.

[12] In the context of a merger, golden parachute compensation arrangements must be disclosed with respect to the NEOs of both the acquirer and the target.

awards, compensation from bona fide post-transaction employment agreements executed in connection with the merger or acquisition or compensation disclosed in the Pension Benefits Table and Nonqualified Deferred Compensation tables.

Item 402(t) also requires a company to provide a narrative description of any material factors necessary to an understanding of the payments disclosed in the table. Such factors include, but are not limited to:

- The specific circumstances that would trigger payment;
- Whether the payments would be lump sum, or annual, their duration, and by whom they would be provided; and
- Any material conditions or obligations applicable to the receipt of golden parachute payments or benefits (*e.g.*, compliance with non-competition and non-solicitation agreements).

A non-binding advisory shareholder vote on the golden parachute arrangements is required, but only in connection with mergers, acquisitions, consolidations and proposed sales or other dispositions of all or substantially all company assets.[13] The new rules exempt a company from holding a say-on-golden-parachutes vote, however, if the golden parachute arrangements, as disclosed under new Item 402(t), were subject to a prior say-on-pay vote. To take advantage of this exception, a company must voluntarily include disclosure in their annual proxy statements regarding change-in-control compensatory arrangements in a manner that satisfies the requirements of Item 402(t), rather than existing Item 402(j).[14] The final rules also make clear that this exception will not apply to new golden parachute arrangements or those that were revised subsequent to the prior say-on-pay vote.[15]

A company must comply with the say-on-golden-parachute voting and disclosure requirements in a merger proxy statement filed on or after April 25, 2011.

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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; Michael Macris at 212.701.3409 or mmacris@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; Michael Sherman at 212.701.3747 or msherman@cahill.com; Glenn Waldrip at 212.701.3110 or gwaldrip@cahill.com; or Abigail Darwin at 212.701.3240 or adarwin@cahill.com.

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13 For example, acquiring companies that solicit proxies to approve the issuance of shares or a reverse stock split in order to conduct the merger transaction must comply with the golden parachute disclosure rules, but such actions do not require an advisory vote.

14 Amounts payable upon termination of employment separate from a change-in-control would still have to be disclosed pursuant to Item 402(j) rules. Also note that if a company elects to voluntarily include the disclosure required pursuant to Item 402(t) in its annual proxy statement, such disclosure would be subject to a say-on-pay vote.

15 The exception would apply, however, if the only changes to the golden parachute arrangements were to reflect movements in the company's stock price or to reflect a reduction in the value of the total compensation payable.

This memorandum is for general information purposes only and is not intended to advertise our services, solicit clients or represent our legal advice.

Exhibit A

Form of table for “say-on-golden-parachute” disclosure

Golden Parachute Compensation

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