

U.S. Securities and Exchange Commission Proposes Say-On-Pay and Vote Reporting Rules

On October 18, 2010, the Securities and Exchange Commission (SEC) issued Release Nos. 33-9153; 34-63124, “Shareholder Approval of Executive Compensation and Golden Parachute Compensation”¹ (Say-On-Pay Proposal), which proposes regulations to implement advisory votes giving shareholders:

- A “say-on-pay” for executive officer compensation
- Input on the frequency of such say-on-pay
- A say-on-pay for “golden parachutes” in the context of change in control transactions.

The Say-On-Pay Proposal also contains golden parachute disclosure requirements. The SEC has requested comments on the Say-On-Pay Proposal by November 18, 2010.

At the same time that the SEC issued the Say-On-Pay Proposal, it issued Release No. 34-63123, “Reporting of Proxy Votes on Executive Compensation and Other Matters”² (Vote Reporting Proposal), proposing regulations requiring institutional investment managers to report how they voted on compensation advisory votes. Comments on the Vote Reporting Proposal are also due by November 18, 2010.

Background

Both the Say-On-Pay Proposal and the Vote Reporting Proposal are required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). For more information about the Dodd-Frank Act, see our

Legal Update “Corporate Governance and Disclosure Implications of the Dodd-Frank Wall Street Reform and Consumer Protection Act,” dated July 21, 2010.³

Say-On-Pay

Proposed new Rule 14a-21(a) under the Securities Exchange Act of 1934 (Exchange Act) provides for a separate advisory vote on executive compensation at least once every three years. The rule does not specify the form or language of the approving resolution. The requirement is that the vote must relate to all named executive officer (rather than director or other employee) compensation that is disclosed pursuant to Item 402 of Regulation S-K.

In addition, proposed new Item 24 of Schedule 14A under the Exchange Act requires issuers to disclose that they are providing a separate shareholder vote on executive compensation and to explain the general effect of the say-on-pay vote, such as whether the vote is non-binding.

Under the Say-On-Pay Proposal, issuers would have to address in their Compensation Discussion and Analysis (CD&A) whether, in determining their compensation policies and decisions, they have considered the results of previous say-on-pay votes required by the Dodd-Frank Act or, for companies that have received financial assistance under the Troubled Asset Relief Program (TARP), pursuant to Rule 14a-20 under the Exchange Act. Companies that have considered the results of such advisory votes

must describe in their CD&A how that consideration has affected their compensation policies and decisions. This new CD&A requirement does not cover say-on-pay votes submitted as shareholder proposals pursuant to Rule 14a-8 under the Exchange Act, or as proposals that were previously submitted voluntarily by issuers.

Frequency of Vote

Rule 14a-21(b) requires issuers to provide a separate advisory vote at least once every six years to determine whether shareholders want the say-on-pay vote for executive compensation to occur every one, two or three years. Item 24 of Schedule 14A would require issuers to disclose in their proxy statements that this advisory vote is occurring, and to explain the general effect of the frequency of the say-on-play vote, such as whether the vote is non-binding. The Say-On-Pay Proposal does not prescribe a standard for determining which frequency has been “adopted.”

A proposed amendment to Rule 14a-4 under the Exchange Act would require issuers to provide four choices for the frequency vote on their proxy card: one year, two years, three years or abstain. While the SEC expects that the boards of directors will provide recommendations as to how frequently shareholders should vote on executive compensation, proxy cards cannot be set up as approving or disapproving of the issuer’s recommendation. As a transitional matter, if a proxy service provider is unable to program its services to accommodate four choices, the SEC will not take action if shareholders are provided only the choice of one-, two- or three-year frequencies (without the abstention choice), as long as shares are not voted in cases where the shareholder did not select one of these three choices.

Timing

All proxy statements, whether in preliminary or definitive form, for the first annual meeting (or

other meeting in which executive compensation disclosure is required in the proxy statement) taking place on or after January 21, 2011 must include separate advisory resolutions for shareholders to approve executive compensation and the frequency of say-on-pay votes, even if final SEC regulations are not yet adopted by the date the proxy statement is filed.

Form 10-Q and 10-K Amendments

An issuer’s Form 10-Q for the period during which the say-on-pay frequency vote occurred (or the Form 10-K if such vote occurs in the fourth quarter) will need to disclose whether and how the issuer will implement the results of the frequency vote for say-on-pay.

No Preliminary Filing

The Say-On Pay Proposal contains an amendment to Rule 14a-6(a) under the Exchange Act so that neither shareholder votes on executive compensation nor frequency votes will trigger a preliminary filing requirement for proxy statements. As a transitional matter, the Say-On-Pay Proposal further indicates that the SEC will not take action if companies filing proxy statements with such say-on-pay proposals or frequency proposals before the effective date of the SEC’s final rules do not file preliminary proxy statements if a preliminary filing is not required as a result of some other proposal contained in the proxy statement.

Rule 14a-8 Changes

Rule 14a-8(i)(10) allows an issuer to exclude a shareholder proposal from its proxy statement to the extent that it has been substantially implemented. Under the Say-On Pay Proposal, a note would be added to this rule that would clarify the status of shareholder proposals requesting either advisory votes on executive compensation or frequency of say-on-pay votes. This note would specify that such shareholder proposals could be excluded as substantially implemented if the company has adopted a

policy on the frequency of say-on-pay votes that is consistent with the plurality of votes cast in the most recent shareholder vote.

Golden Parachute Disclosure

The SEC has proposed new Item 402(t) of Regulation S-K. With respect to each named executive officer of the acquiring company and the target company, Item 402(t) would require disclosure of agreements or understandings, whether written or unwritten, between each such named executive officer and the acquiring company or the target company concerning any type of compensation, whether present, deferred or contingent, that is based on or otherwise relates to an acquisition, merger, consolidation, or sale or other disposition of substantially all of the assets of the issuer. The SEC determined that the existing disclosure requirement of Item 402(j) of Regulation S-K is not sufficient to satisfy the Dodd-Frank mandate. The new disclosure needs to be presented in both tabular and narrative formats.

Item 402(t) requires a new Golden Parachute Compensation Table in order to present quantitative disclosure of the aggregate dollar value of the following individual elements of golden parachute compensation:

- Cash severance payments (e.g., base salary, bonus and pro-rata non-equity incentive plan payments)
- Accelerated stock awards, in-the-money option awards for which vesting would be accelerated, and payments in cancellation of stock and option awards
- Pension and nonqualified deferred compensation benefit enhancements
- Perquisites and other personal benefits and health and welfare benefits
- Tax reimbursements (e.g., tax gross-ups)
- “Other” additional elements of compensation not otherwise specifically includable.

The Golden Parachute Compensation Table would also include a column for totals. Dollar amounts based on stock price would be calculated based on the closing price per share as of the latest practicable date, except that if the disclosure is included in an annual meeting proxy statement, it would be based on the closing price per share as of the last business day of the issuer’s last completed fiscal year. If there are golden parachute arrangements between the acquiring company and the named executive officer of a soliciting target company, an additional Golden Parachute Compensation Table is required to clarify which compensation is the subject of the golden parachute advisory vote, if such compensation is different from the full scope of the golden parachute disclosure.

Compensation would have to be disclosed under Item 402(t) only to the extent that the compensation is based on, or otherwise relates to, the transaction. Separate quantification of the compensation disclosed in the Pension Benefits Table or the Nonqualified Deferred Compensation Table would not be needed and there would be no requirement to disclose previously vested equity awards. The golden parachute disclosure would not have to include post-transaction employment agreements, although such agreements may trigger separate disclosure requirements (e.g., if the future employment agreement constitutes a “substantial interest” in the matter to be voted upon).

The golden parachute narrative disclosure must identify the specific circumstances that would trigger payment. This disclosure would have to state whether the payments would (or could) be lump sum or annual, and would have to disclose the duration of the payments and by whom they would be provided. The narrative would also have to describe any material conditions or obligations applicable to the receipt of payment or benefits, including but not limited to non-compete, non-solicitation, non-disparagement or confidentiality agreements, including the

duration of such agreements and provisions regarding waiver or breach.

The golden parachute disclosure will not be limited to transactions requiring proxy statements. To make the disclosure applicable regardless of the form of the extraordinary transaction, the SEC is also proposing to require the Item 402(t) disclosure 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
- Third-party tender offers on Schedule TO and Schedule 14D-9 solicitation/recommendation statements.

An exception has been proposed for agreements and understandings with senior management of a foreign private issuer. The golden parachute disclosure will be required after the SEC's rules become effective.

Golden Parachute Advisory Vote

Rule 14a-21(c) would require a separate advisory vote on golden parachute compensation in proxy statements for meetings where shareholders are asked to approve an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all of the assets. This advisory vote would only be needed with respect to compensatory agreements or arrangements that are required to be disclosed pursuant to Item 402(t) of Regulation S-K. As with the executive compensation say-on-pay vote, the rule does not require issuers to use any specific language or form of resolution. This shareholder vote would not be binding. The golden parachute advisory vote will be required

for proxy statements for meetings at which an extraordinary transaction will be voted upon that occur after the SEC's rules become effective.

A golden parachute advisory vote is not required if the compensation was the subject of a prior executive compensation say-on-pay vote, regardless of whether the shareholders approved such compensation. In order to use this exception, however, the proxy statement for the prior say-on-pay vote must have included the golden parachute disclosure required by Item 402(t) of Regulation S-K. Accordingly, some issuers may choose to voluntarily include that disclosure in their annual meeting proxy statements when obtaining an executive compensation say-on-pay vote.

The exception for a prior say-on-pay vote is only available to the extent the same golden parachute arrangements are in effect without modification. New or revised arrangements would still be subject to a golden parachute advisory vote. In such a circumstance, two separate Golden Parachute Compensation Tables would be required. One table would disclose all golden parachute compensation while a second table would disclose only the new or revised arrangements that are subject to a vote.

TARP Companies

Companies that have received financial assistance under TARP will continue to provide annual say-on-pay votes under Rule 14a-20 as long as TARP indebtedness is outstanding. Therefore, during such period, they will not also have to conduct an additional say-on-pay or frequency vote under Rule 14a-21. TARP companies are required to include CD&A disclosure of how the result of a previous say-on-pay vote impacted executive compensation policy and decisions. The proxy statement for the first annual meeting after TARP indebtedness has been fully repaid would be required to contain the say-on-pay and frequency votes required by Rule 14a-21.

Smaller Reporting Companies

Smaller reporting companies will be required to comply with the advisory vote and most of the disclosure requirements of the Say-On-Pay Proposal. However, because such companies do not have to provide CD&A, the amendments to the CD&A requiring discussion of the impact of a prior say-on-pay vote on compensation decisions and policies will not apply to them. The Say-On-Pay Proposal notes that the consideration of a prior say-on-pay vote could be a material factor to be addressed in the narrative that accompanies the Summary Compensation Table.

No Broker Discretionary Voting

Brokers will not be permitted to vote uninstructed shares in the say-on-pay vote or the frequency vote. Broker discretionary voting in connection with merger or acquisition transactions is not permitted under current rules of the national securities exchanges.

Reporting of Voting by Institutional Managers

The Vote Reporting Proposal would require institutional investment managers that file reports under Section 13(f) of the Exchange Act to annually report how they voted on executive compensation say-on-pay, say-on-pay frequency and golden parachute say-on-pay votes. This would be done annually on Form N-PX. While Form 13F reporting is based on investment discretion, this new reporting requirement would be based on voting power. Votes would be reported if the manager had or shared voting power over these items, without regard to whether the manager had voting power over other matters. The voting information would need to be reported by August 31 of each year with respect to the most recent 12-month period ended June 30.

Practical Considerations

- In an effort to implement its regulations by the effective date mandated by the Dodd-Frank Act, the SEC has set a very short time frame for comments on its Say-On-Pay Proposal. Anyone wishing to submit comments to the SEC, or to join an industry group comment letter, on this topic needs to do so very quickly.
- All public companies that will be holding annual meetings on or after January 21, 2011 must include say-on-pay proposals and frequency of vote proposals in their upcoming proxy statements. Because this involves new proxy statement language, it would be productive to begin the drafting process well in advance of filing deadlines. Companies should thoughtfully develop the rationale they will provide shareholders to encourage votes in support of their executive compensation policies. Because of the sensitivity of this issue, companies should allow time for this section to be reviewed and revised by management, the compensation committee and the full board. In addition to drafting these new proxy statement proposal sections, the entire proxy statement and proxy card should be reviewed to determine where revisions are appropriate to reflect the say-on-pay and frequency of vote proposals.
- The CD&A will need to discuss how compensation decisions were impacted by the result of the say-on-pay advisory votes required by either Rule 14a-21 or Rule 14a-20. TARP public companies will need to prepare that disclosure for their upcoming CD&A sections. Other public companies should consider whether to voluntarily address this question in advance of this year's advisory vote if they know how the compensation committee intends to take the say-on-pay vote into account or by discussing how they considered the proposed say-on-pay vote.
- Public companies should check if their voting tabulators can process four choices for the

frequency vote proposal on the proxy card, as contemplated by the SEC. Where this procedure cannot be accommodated, companies should implement a policy against voting undirected proxy cards on any of the frequency proposal options.

- Public companies should consider adopting a policy on the frequency of say-on-pay votes that is consistent with the plurality of votes cast in the most recent shareholder vote in order to be able to exclude shareholder proposals for say-on-pay or say-on-pay frequency from their proxy statements in the future.
- Public companies should determine what frequency of say-on-pay vote they will recommend to shareholders. Companies that find this additional proposal burdensome and without commensurate shareholder value will likely recommend a frequency of once every three years. However, it is possible that taking a middle ground by recommending a two-year frequency might reduce the number of votes favoring an annual say-on-pay proposal.
- Because a golden parachute advisory vote at the time of a transaction is not needed if the compensation was subject to a prior say-on-pay advisory vote, some public companies may want to expand their potential termination compensation disclosure in their annual proxy statements so that it complies with the new golden parachute disclosure requirements set forth in Item 402(t) of Regulation S-K. Companies considering this should note that if subsequent changes are made to these arrangements prior to a transaction, those changes will be highlighted by the inclusion of a separate table in the proxy statement for the subsequent transaction and will be subject to a golden parachute advisory vote.
- Public companies should add a disclosure control to their existing procedures so that the quarterly report on Form 10-Q for the quarter in which the frequency vote occurs (or the annual report on Form 10-K where the vote

occurs during the fourth quarter) contains the necessary disclosure regarding the implementation of the frequency vote.

Endnotes

¹ Available at <http://www.sec.gov/rules/proposed/2010/33-9153.pdf>.

² Available at <http://www.sec.gov/rules/proposed/2010/34-63123.pdf>.

³ Available at <http://www.mayerbrown.com/securities/article.asp?id=9371&nid=10707>.

If you have any questions regarding the Say-on-Pay Proposal or Vote Reporting Proposal, please contact the author of this Legal Update, Laura D. Richman, at +1 312 701 7304, or any of the lawyers listed below or any other member of our Corporate & Securities group.

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