# SEC Issues Final 'Say on Pay' Rules

On January 25, the SEC issued final rules implementing the three "say on pay" voting provisions mandated by the Dodd-Frank Act – the vote on approval of executive compensation ("say on pay"), the vote on the frequency of future say on pay votes ("say on frequency"), and the vote on approval of compensation payable in connection with a merger or other corporate transaction ("say on parachutes"). The adopting release confirms that all three votes are advisory and non-binding.

***Effective Dates.*** The "say on pay" and "say on frequency" rules are generally effective 60 days after publication in the Federal Register. However, the statutory provisions requiring these votes are already effective. Companies filing proxy statements before the SEC rules become effective may nevertheless want to look to the rules for guidance in crafting their disclosures. The "say on parachutes" rules are generally effective for initial filings made on or after April 25, 2011.

"Smaller reporting companies" (as defined for purposes of Exchange Act filings) are subject to these rules, but need not comply with the say on pay and say on frequency provisions until shareholder meetings occurring on or after January 21, 2013. The rules generally do not apply to foreign private issuers.

## Say on Pay

***Scope of Proposal.*** The say on pay vote must be held at least once every three calendar years. The company must provide a separate shareholder advisory vote to approve the compensation of the company's named executive officers (*i.e.,* the officers whose compensation is required to be disclosed in the proxy statement) as such compensation is disclosed under Item 402 of Regulation S-K. The vote must cover both the Compensation Discussion and Analysis ("CD&A") and the compensation tables and related narrative. (For smaller reporting companies, the vote would be based on the simplified compensation disclosures applicable to them, which do not include a CD&A.) The rules do not prohibit a shareholder vote on a narrower aspect of compensation policy as long as it is in addition to the mandated vote.

Although the rules provide that the proxy statement shall "include a separate resolution" with respect to each of the say on pay (and say on frequency) votes, the adopting release states that no specific language or form of resolution is required. Thus it is not clear if the proposal must include a formal "Resolved" clause. The rules provide the following non-exclusive example of a say on pay resolution: "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."

The say on pay vote does not encompass director compensation or the company's compensation policies as they relate to risk-taking by non-executive employees. Discussion of compensation policies affecting risk-taking by named executive officers should be included in the CD&A, and thus would be covered by the say on pay proposal.

***Required Disclosure.*** The rules require proxy statements to expressly state that the say on pay proposal is required by the proxy rules and to explain "the general effect of [the] vote," such as stating that the vote is non-binding. (These disclosure requirements also apply with respect to the say on frequency and say on parachutes proposals.) In addition, the proxy statement must state the current frequency of the company's say on pay votes and when the next such vote will occur.

Companies are also required to state in their CD&A "whether and, if so, how" the company has considered the result of its most recent say on pay vote (under either the Dodd-Frank Act or the TARP requirements) and, if so, how that consideration has affected the company's executive compensation decisions and policies. Although the mandatory disclosure relates to only the most recent say on pay vote, the SEC release states that companies should also discuss their consideration of earlier say on pay votes to the extent material to their compensation

policies and decisions. (Smaller reporting companies, while not required to provide a CD&A, are expected to include similar information if the say on pay vote was a material factor affecting their compensation decisions.)

***No Preliminary Proxy Statement.*** The final rules confirm that say on pay and say on frequency proposals do not require filing of a preliminary proxy statement, and, beginning on the effective date of the rules, extend the provision to cover all shareholder advisory votes on executive compensation.

### Say on Frequency

The say on frequency vote must be held at least once during the six calendar years following the prior say on frequency vote. Shareholders must be given a choice as to whether advisory say on pay votes will occur every 1, 2, or 3 years. The rules do not provide a form of resolution or sample language for the say on frequency vote. The rules specify that the proxy card must present four choices with respect to this proposal – every 1, 2, or 3 years, or abstain. While the issuer is permitted to make a recommendation, the vote cannot be limited to approval or rejection of the issuer's recommendation.

As a transition matter, to accommodate proxy service providers that may need additional time to program their systems to provide the three choices plus a box for abstentions, the SEC will not object if proxy cards with respect to shareholder meetings held on or before December 31, 2011 provide a choice of 1 year, 2 years, or 3 years – without a box to indicate abstention – provided that the proxy will not be voted on the say on frequency proposal unless one of the three choices is indicated. However, in order for the company to be able to vote uninstructed shares in accordance with management's recommendation, the proxy statement must (1) include a statement of management's recommendation, (2) permit abstentions on this item, and (3) include a statement of how uninstructed shares will be voted in bold on the proxy card.

***Effect on Shareholder Proposals.*** The SEC has also amended Rule 14a-8 (the rule governing when a company may exclude a shareholder proposal from the company's proxy statement) to provide that a company may exclude a shareholder proposal dealing with say on pay or say on frequency only if the company has adopted a voting policy consistent with the choice (if any) that received a majority of the votes cast in the most recent say on frequency vote. The new exclusion would apply only with respect to say on pay or frequency proposals having the same broad scope as the mandatory proposals, and would not apply to narrower shareholder proposals dealing with a specific element of compensation. (The SEC release states that requests to exclude shareholder proposals seeking advisory votes on different aspects of executive compensation will be evaluated by the staff on a case-by-case basis.)

***Disclosure of Company's Frequency Decision.*** In addition to the existing Form 8-K requirement to disclose the results of all shareholder votes within four business days after the date of the meeting, Form 8-K has been amended to require companies to disclose the company's decision regarding how frequently it will hold say on pay votes. The filing will be due no later than 150 calendar days after the date of the shareholder meeting, but in no event later than 60 days before the deadline for submission of shareholder proposals for the next annual meeting.

***Application to TARP Companies.*** While for most companies the first say on frequency vote is required for the first annual meeting occurring on or after January 21, 2011, companies with outstanding TARP indebtedness, which are required under the TARP rules to have an annual say on pay vote, are not required to have a say on frequency vote until the first annual meeting after their TARP indebtedness has been repaid.

### Say on Parachutes

***Required Disclosure.*** In order to implement the new say on parachutes requirement, the final rules add a new Item 402(t) to Regulation S-K, requiring disclosure of executive compensation arrangements "based on or otherwise related to" a merger or other corporate transaction. The disclosure of such "golden parachute" arrangements is required not only for the transactions specified in the Dodd-Frank Act (merger, acquisition, consolidation, or sale of all or substantially all assets), but also for SEC filings with respect to other specified significant corporate transactions such as certain tender offers and going private transactions.

The disclosure is required to be provided in a Golden Parachute Compensation table and accompanying narrative, detailing compensation based on or related to the transaction which is payable by either the acquiring company or the target company to a named executive officer of either company. Separate columns are required for each of the following:

- Cash severance payments (including salary, bonus, and pro-rated non-equity incentive plan payments)
- Equity (including the dollar value of accelerated stock awards, the aggregate spread of accelerated in-the-money option awards, and payments in cancellation of any stock or option awards)
- Pension or deferred compensation benefit enhancements
- Perquisites and health and welfare benefits (unlike the rules for annual proxy statements, disclosure is required even if the aggregate value of perquisites is below $10,000 and even if health and welfare benefits are provided on a nondiscriminatory basis)
- Tax reimbursements (including parachute gross-up payments)
- Other (with each component separately identified)
- Total of these amounts

In quantifying amounts payable, the company is required to assume that the triggering event took place on the latest practicable date. In a change from the proposed rules, equity awards in the table must be valued based on the per share deal price, if this is a fixed dollar amount, and otherwise on the average closing price over the five business days following public announcement of the transaction. (If the table is included in an annual proxy statement, the amounts would be calculated on the assumption that the triggering event occurred on the last day of the fiscal year, and the value of equity awards would be calculated using the closing price on that date.) Companies are permitted to add additional columns or rows to the table – for example to separately break out certain elements of compensation – so long as the disclosure is not misleading.

In each column, disclosure is required only for amounts payable based on or otherwise relating to the transaction. However the SEC apparently views a cash-out of previously-vested options or stock awards as covered by this criterion. Amounts payable on a single trigger (payable upon the transaction without regard to any other condition) and those payable on a double trigger (requiring both a termination of employment and occurrence of the transaction) must be separately quantified. Disclosure of double trigger amounts must include the time period in which the termination of employment must occur in order for the amount to be payable. If any column includes more than one form of compensation, each separate form must be quantified by footnote.

The table is not required to include compensation pursuant to employment agreements with respect to post-transaction employment. The SEC release notes, however, that disclosure of such arrangements may be required under the existing proxy disclosure item calling for disclosure with respect to "substantial interests" in the transaction.

If there are uncertainties as to whether an element of golden parachute compensation will be paid or the amount of the payment, the table must include a reasonable estimate, and the narrative must identify the material assumptions underlying the estimate, and the specific conditions under which the payment would be made. The narrative must state by whom each payment would be made, whether each type of payment would be lump sum or over a period of time, and in the latter case, the duration of such payments, as well as any other material factors regarding each compensation arrangement. The narrative must also disclose any non-compete or similar conditions to receipt of the compensation and any provisions regarding waiver of such provisions.

***Shareholder Vote.*** While the SEC rules expand the scope of golden parachute compensation disclosure required beyond that required by the Dodd-Frank Act, the rules limit the mandatory say on parachutes vote to the scope required by the Dodd-Frank Act. Thus, the vote is required only in proxy statements of either acquiring or target companies seeking approval of the acquisition transaction. In addition, the vote is limited to arrangements between the soliciting company and its named executive officers and between a target soliciting company and the named executive officers of the acquiring company. Notably, the target company need not submit arrangements between its named executive officers and the acquiring company to a say on parachutes vote.

***Limited Prior Vote Exception.*** Consistent with the Dodd-Frank Act, the SEC rules provide that the separate say on parachutes vote is not required at the time of the transaction if the arrangements have been subject to a previous say on pay vote (whether or not approved by shareholders). Golden parachute arrangements are treated as having been subject to a prior say on pay vote only if the information required by new S-K Item 402(t) was included in a prior proxy statement and thus subject to the general say on pay vote.

Any changes to previously voted-on disclosure of golden parachute arrangements will require a new vote, except for changes (1) reflecting fluctuations in the price of the company's securities or (2) reducing the value of the total

compensation payable. Specifically, the adoption or amendment of compensation arrangements, the addition of a new named executive officer, changes due to ordinary course salary increases, and new equity grants in the ordinary course will all require a new vote. Moreover, a new vote will be required even absent any changes by the company if the transaction causes a parachute tax gross-up to become payable, for example where a gross-up is payable solely due to an increase in the company's stock price. In any of these situations, only the new arrangements and revised terms will be subject to the say on parachutes vote.

***Number of Item 402(t) Tables.*** Companies that previously included Item 402(t) information in an annual proxy statement are required to provide two separate Item 402(t) tables in their merger proxy statements – one containing the new or revised compensation information that is subject to the say on parachutes vote and the other containing all golden parachute compensation required to be discussed under Item 402(t). While not clear from the SEC release, presumably a company could choose to subject all of its golden parachute compensation (including portions previously subject to a say on pay vote) to the say on parachutes vote, in which case the company should be permitted to provide only a single Item 402(t) table.

In an analogous situation, where a target company provides disclosure of compensation arrangements between its named executive officers and the acquiring company – which are required to be disclosed but are not required to be subject to a say on parachutes vote – the rules expressly provide that the target company can choose to either exclude this compensation from the say on parachutes vote, in which case it must provide this information in a separate Item 402(t) table, or subject it to the vote, in which case it must include it in the Item 402(t) table that is subject to the vote.

---

For more information about the say on pay rules, or other executive compensation and corporate governance provisions of the Dodd-Frank Act, or Hughes Hubbard's executive compensation and corporate governance practices, please contact any of the following attorneys:


Gloria W. Nusbacher
(212) 837-6719
nusbache@hugheshubbard.com

Bruce N. Goldberger
(212) 837-6781
goldberger@hugheshubbard.com

Gary J. Simon
(212) 837-6770
simon@hugheshubbard.com

Spencer L. Harrison
(212) 837-6858
harrison@hugheshubbard.com

Ellen S. Friedenberg
(212) 837-6465
frieden@hugheshubbard.com

John K. Hoyns
(212) 837-6762
hoyns@hugheshubbard.com


Executive Compensation Practice and
Corporate Governance Practice
January 2011

Hughes Hubbard & Reed LLP
One Battery Park Plaza | New York, New York 10004-1482 | 212-837-6000



Ethics rules require this to be labeled attorney advertising.
Readers are advised that prior results do not guarantee a similar outcome.

This e-ALERT is for informational purposes only and is not intended to be and should not be relied on for legal advice. If you wish to discontinue receiving e-ALERTS, please send an email to opt-out@HughesHubbard.com.

© 2011 Hughes Hubbard & Reed LLP