

## Employee Benefits & Executive Compensation ADVISORY

January 26, 2011

### SEC Adopts Final Rules Implementing Dodd-Frank “Say on Pay” and “Say on Golden Parachutes”

On January 25, 2011, in a 3–2 vote, the Securities and Exchange Commission (“Commission”) adopted final rules under the Securities Exchange Act of 1934 (“Exchange Act”) to implement the provisions of Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) relating to three new shareholder advisory votes on (1) executive compensation (the “Say on Pay” vote), (2) the frequency of Say on Pay votes (the “Say on Frequency” vote) and (3) golden parachute compensation relating to changes in control (the “Say on Parachutes” vote).

The final rules largely followed the Commission’s proposed rules issued on October 18, 2010, with a few notable exceptions.

#### Say on Pay Vote

Final Rule 14a-21(a) requires companies, at least once every three calendar years, to provide a separate shareholder advisory vote in proxy statements to approve the compensation of executives, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation, Discussion and Analysis (CD&A), the compensation tables and other narrative executive compensation disclosures required by Item 402. Other key points about the Say on Pay vote include the following, all of which are generally consistent with the Commission’s proposed rules issued on October 18, 2010:

- No specific language is required for the Say on Pay resolution.
- The Say on Pay vote is advisory only and, as such, is not binding on the company or its board of directors. The proxy statement must disclose the non-binding nature of the vote.
- Inclusion of a Say on Pay vote does not trigger a preliminary proxy filing.
- The compensation of directors is not subject to the shareholder vote.
- The result of the Say on Pay vote must be disclosed on a Form 8-K within four business days after the shareholders meeting at which the vote is held.
- Companies are required to address in the next CD&A whether and, if so, how they have considered the most recent Say on Pay vote and, if so, how that consideration has affected their compensation decisions and policies.

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- For listed companies, brokers are not permitted to vote uninstructed shares in a Say on Pay proposal.
- Institutional investment managers are required to file with the Commission their record of voting on Say on Pay and Say on Frequency proposals, including whether the vote was for or against management's recommendation.
- Companies that have received financial assistance under the Troubled Asset Relief Program (TARP) are not required to comply with the Dodd-Frank Act say on pay rules until they are no longer subject to the annual say on pay vote required under TARP. However, they will be required 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 TARP say on pay vote.

*The final rules differ from the proposed rules with respect to the Say on Pay vote in the following areas:*

- The final rules clarify that the Say on Pay vote is required only with respect to annual or special meetings at which directors are being elected, and that the vote is required not less frequently than every three *calendar* years.
- Smaller reporting companies (public float of less than \$75 million) will enjoy a two-year temporary exemption from the need to hold a Say on Pay vote.
- While it remains true that no specific language is required for the Say on Pay resolution, the final rules provide the Say on Pay proposal must include language that the vote is on compensation paid to the company's named executive officers, as disclosed pursuant to Item 402, and the rules now provide a non-exclusive example of a resolution that would satisfy the applicable requirements. Companies are free to solicit shareholder votes on a range of additional compensation matters to obtain more specific feedback on the company's compensation programs and policies.

**Observations:**

While more than a few companies have submitted their executive pay programs to shareholder voting on a voluntary basis, 2011 is the first year of mandatory Say on Pay in the United States. All eyes will be on the voting results from several annual meetings being held this week, including Monsanto on January 25, Johnson Controls on January 26, and Costco Wholesale and Visa on January 27. These companies, like many others, have taken special care this year to make sure their compensation disclosures deliver a clear presentation, making it as easy as possible for shareholders to understand and evaluate the compensation paid to their leadership teams.

## Say on Frequency Vote

Under final Rule 14a-21(b), companies are required, at least once every six calendar years, to allow shareholders to vote, on a non-binding advisory basis, as to whether the Say on Pay vote will occur every one, two or three years. Other key points about the Say on Frequency vote include the following, which are consistent with the proposed rules:

- No specific language is required for the Say on Frequency proposal. Some companies have chosen to pose the vote in the form of a resolution, while others have taken a more informal approach in this proposal.
- Like the Say on Pay vote, the Say on Frequency vote is advisory only and, as such, is not binding on the company or its board of directors. The proxy statement must disclose the non-binding nature of the vote.
- Inclusion of a Say on Frequency vote does not trigger a preliminary proxy filing.
- For listed companies, brokers are not permitted to vote uninstructed shares in a Say on Frequency proposal.
- In the Say on Frequency proposal, shareholder must be presented with four choices as to the frequency of Say on Pay votes: (1) every year, (2) every two years, (3) every three years or (4) abstain. The proxy statement must be clear that shareholders have these four choices and are not voting, instead, on the approval or disapproval of management's recommendation as to the Say on Pay frequency.
- The result of the Say on Frequency vote must be disclosed on a Form 8-K within four business days after the shareholders meeting at which the vote is held.

*The following are key points about how the final rules differ from the proposed rules with respect to the Say on Frequency vote:*

- The final rules clarify that the Say on Frequency vote is required only with respect to annual or special meetings at which directors are being elected, and that the vote is required not less frequently than every six *calendar* years.
- Proxy statements, where applicable, must disclose the current frequency of the Say on Pay vote and when the next scheduled Say on Pay vote will occur.
- Smaller reporting companies will enjoy a two-year temporary exemption from the need to hold a Say on Frequency vote.
- No later than 150 days after the annual meeting at which a Say on Frequency vote is held (but not less than 60 days before the deadline for the submission of shareholder proposals for the next annual meeting), the company must disclose in a Form 8-K its decision on how frequently the company will hold Say on Pay votes in light of the Say on Frequency vote. The proposed

rules had required that this information be filed in the next Form 10-Q filed following the Say on Frequency vote (or Form 10-K if the vote occurs in the company's fourth quarter). In response to public comments, the Commission provided more time for a company to fully consider the results of the vote, including through board deliberation and consultation with shareholders, before making a decision as to its policy on the frequency of future Say on Pay votes.

- If any one of the three frequency alternatives receives a *majority* of the votes cast, a company that adopts a policy on the frequency of Say on Pay votes that is consistent with such majority-approved frequency schedule may exclude under Rule 14a-8(i)(10) any shareholder proposal that seeks a Say on Pay vote or relates to future Say on Pay or Say on Frequency votes. The proposed rules had provided this relief for companies going along with the frequency alternative that received a *plurality* of the votes cast. The Commission acknowledged that it is possible that no one frequency alternative would receive majority support and that, in such case, the company would not be able to exclude subsequent shareholder proposals regarding say on pay, even if it adopted the frequency having the support of a plurality of the votes cast.

#### **Observations:**

A company's board is not required to make any recommendation on the frequency proposal. If it wishes to do so, there is no "right answer" and there are several factors to consider, including what its shareholders are likely to prefer:

- The 2011 voting guidelines of Institutional Shareholder Services (ISS) indicate that ISS will uniformly recommend in favor of *annual* Say on Pay votes.
- A growing number of institutional investors are saying they also favor annual votes, but at least a few (including, for example, United Brotherhood of Carpenters and Joiners) have signaled they favor a less frequent vote, presumably to spread out the administrative burden of evaluating thousands of proxy statements.
- If possible, a board should ascertain what the preferences of the company's largest shareholders are as to the frequency vote. Some institutional shareholders have published guidelines but not all do.

Of the 153 companies that had filed proxy statements through January 21, 2011, containing Say on Frequency proposals, a surprising majority (almost 54 percent) recommended that the shareholders approve a triennial Say on Pay, and approximately 31 percent recommended an annual Say on Pay vote. This week heralds the first annual meetings in which shareholders' voices will be heard on the frequency issue (watch especially for annual meetings of Monsanto on January 25, Johnson Controls on January 26 and Costco Wholesale on January 27). It will be interesting to see both how companies recommending a triennial or biennial schedule will respond if their shareholders register a preference for an annual Say on Pay vote, and how the early voting returns will affect management recommendations in proxy statements to be filed later this winter.

## Disclosure of Golden Parachutes and the Separate Say on Parachutes Vote

### **Golden Parachute Disclosures**

New Item 402(t) of Regulation S-K implements the Dodd-Frank Act golden parachute disclosure requirements. As proposed, the final rules require both tabular and narrative disclosure of named executive officers' golden parachute arrangements in the proxy materials for a meeting of shareholders to approve a change in control of the company. Highlights of the final rules that are consistent with the proposed rules are as follows:

- The disclosure of golden parachute compensation for the Say on Parachute vote must be in both tabular and narrative form:
  - **Tables.** The rules prescribe a specific tabular format for these disclosures, which include cash payments, the value of accelerated options and stock awards, payments in cancellation of options and stock awards, pension and nonqualified deferred compensation enhancements, perquisites and other personal benefits, health and welfare benefits, tax reimbursements and gross-ups, and any other benefit not specifically includable in the other categories. The table must also include the aggregate total of all such compensation. Footnotes to the table would give other pertinent information, such as whether the arrangements are “single-trigger” or “double trigger.” There is no exclusion of de minimis amounts.
  - **Narrative.** The narrative disclosure must describe the specific circumstances that would trigger the payment, who would make the payments, the form of payment (such as lump sum or installments), and any material conditions applicable to the payment (such as compliance with restrictive covenants).
- The current disclosure required by Item 402(j) of Regulation S-K (Potential Payments upon Termination of Employment or Change in Control) does not satisfy the statutory requirements of the Dodd-Frank Act with respect to golden parachute arrangements.
- Although the Dodd-Frank Act requires disclosure of golden parachute arrangements between the person conducting the solicitation (typically the target company) and its named executive officers (or if applicable, the named executive officers of the other company), Item 402(t) also requires disclosure of golden parachute arrangements between the *acquiring* company and the named executive officers of either company, provided such parachute arrangements are based on or related to the subject transaction. In this case, two tables are required: one showing golden parachute arrangements with both constituent companies to the transaction and one showing just parachute arrangements with the target company.
- Item 402(t) disclosure is required in any proxy solicitation for a change-in-control approval meeting, regardless of whether the company is required to include a Say on Parachutes vote, as discussed below.

### ***Say on Parachutes Vote***

Final Rule 14a-21(c) requires companies to provide in the proxy statement for a change-in-control approval meeting a separate shareholder advisory vote on certain golden parachute arrangements. Highlights of the final rules in this regard include the following:

- No specific language is required for the Say on Parachute vote.
- The Say on Parachutes vote is not binding on the company or its board of directors.
- Golden parachute arrangements between the *acquiring* company and the named executive officers of the target company need not be subjected to the Say on Parachutes vote—even though such arrangements are required to be disclosed pursuant to Item 402(t). Companies must provide a separate table of the arrangements subject to the shareholder advisory vote, if different from the full scope of golden parachute compensation being disclosed pursuant to Item 402(t).
- Moreover, a Say on Parachutes vote is not required for compensation that has been subjected to a prior Say on Pay vote (whether or not previously approved in the Say on Pay vote). However, this exception is available only to the extent the parachute arrangements previously subject to the Say on Pay vote remain unchanged from the prior vote (although a change that merely reduces the value of the compensation will not trigger the need for a new vote). New or modified golden parachute arrangements, including new awards granted after the Say on Pay vote under a previously disclosed plan, would be subject to the separate Say on Parachutes vote.
- If a Say on Parachutes vote is required, it may be limited to only the new or revised compensation since the most recent Say on Pay vote, as opposed to *all* of the golden parachute arrangements for the subject transaction. In that case, the company would provide two separate Item 402(t) tables in the change-in-control proxy statement. One table would show *all* golden parachute compensation, regardless of prior Say on Pay voting exposure; the second table would disclose only those new arrangements or revised terms subject to the Say on Parachutes vote. We predict that many companies, to avoid voter confusion, will instead choose to subject all of the golden parachute arrangements to the Say on Parachute vote, rather than to follow this bifurcated presentation.

*Highlights of the final golden parachute rules that are different from the proposed rules are as follows:*

- The Dodd-Frank Act requires the golden parachute disclosures in connection with an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all the assets of the company. The final rules expand the types of covered transactions for *disclosure* purposes (but not for purposes of the voting requirements) to include going-private transactions, tender offers and any transactions for which a proxy statement or similar form is required to include disclosure of information under Item 14 of Schedule 14A. Bidders in third-party tender offers, however, are not required to provide the Item 402(t) disclosures.

- The golden parachute rules apply to proxy statements and other schedules and forms initially filed on or after April 25, 2011, with respect to change-in-control approval meetings.
- Smaller reporting companies will *not* have a two-year exemption from the golden parachute disclosure and voting requirements.

**Observations:**

At this point, it doesn't appear that many companies plan to take advantage of the exception to the Say on Parachutes vote by subjecting Item 402(t) disclosures to an earlier Say on Pay vote. The main reasons are that:

- The lengthy Dodd-Frank Act golden parachute disclosures will add complexity to the annual proxy statement in an area that is already long and often confusing to shareholders.
- ISS has indicated that if a company includes the additional Say on Parachutes disclosure in its annual proxy statement, this information will "carry more weight" in ISS' overall recommendation regarding the Say on Pay vote.
- In all likelihood, including the Item 402(t) information in the annual proxy statement will not avoid a later Say on Parachutes vote in the change-in-control proxy statement because the Commission's rules have placed very narrow parameters around the exemption.
- If a company does end up having a separate Say on Parachutes vote in the change-in-control proxy statement, it will have been made more complex by having to include multiple tables distinguishing between previously voted-on and new golden parachute arrangements.
- The later Say on Parachutes vote will be non-binding in any event.

**Effective Dates**

Consistent with the proposed rules, the Say on Pay and Say on Frequency proposals must be included in a company's first annual or other meeting of the shareholders occurring on or after January 21, 2011. Under the final rules, disclosure regarding golden parachute arrangements and the Say on Parachutes vote will be required for change-in control proxy statements and similar forms initially filed on or after April 25, 2011.

**Other Commission Action**

Also on January 25, 2011, the Commission proposed rules requiring [disclosure by advisers to hedge funds](#) and other private funds, as well as proposed rules implementing [Dodd-Frank's revisions](#) to the definition of [accredited investors](#). These proposed rules are the subject of separate Alston & Bird advisories.

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