CAPflash
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# SEC Proposed Rules on Say on Pay

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On October 18, 2010, the Securities and Exchange Commission (SEC) released proposed rules for the implementation of the Say on Pay and Say on Golden Parachutes provisions of Section 951 of the "Dodd-Frank Wall Street Reform and Consumer Protection Act". The proposed rules provide needed guidance to companies preparing to develop Say on Pay proposals for the Spring 2011 proxy season, with final rules expected from the SEC between January and March of 2011. The timing of the final rules may create challenges for companies with shareholder meetings the first quarter of 2011, as Say on Pay is required for all proxy statements filed for annual meetings after January 21, 2011. For companies with annual meetings after January 21, 2011, but before the final rules are issued, the proposed rules will have to serve as the final guidance for developing their Say on Pay proposals.

## Highlights of the Guidance on Say on Pay

The proposed rules contain some good news for companies, as the SEC confirmed that the new advisory votes on Say on Pay and Say on Pay frequency will not trigger the filing of a preliminary proxy statement. The SEC also directed that broker discretionary voting of uninstructed shares is not permitted for Say on Pay or Say on Pay frequency votes. Below are highlights of the proposed rules for the Say on Pay and Say on Pay Frequency votes.

### *Advisory Vote on Say on Pay*

The SEC guidance does not specify a form for the language of the Say on Pay vote resolution. However, the proposed rules state that the resolution should indicate that the vote is advisory only and that the vote will cover all aspects of executive compensation for the Named Executive Officers of the company as disclosed in the CD&A, compensation tables and accompanying narrative. Compensation of directors and the risk assessment of the compensation programs for all employees are not intended to be included in the Say on Pay vote. In future CD&A disclosure, companies will need to discuss how their compensation policies and decisions have been influenced by past Say on Pay votes.

### *Vote on Frequency of Say on Pay Votes*

The SEC guidance on the frequency of Say on Pay votes confirms that shareholders will have to be provided with four choices on frequency:

- Every year
- Every two years
- Every three years
- Abstain

While companies are required to provide shareholders with all four of the above choices, the proposed rules do not preclude the company from stating its preference among the alternatives. In the proposed rules, the SEC also confirmed that the vote on the frequency of the Say on Pay vote is advisory in nature and not binding on the company. That is, if a company's stated frequency preference does not win the plurality of votes, the company can still go ahead and conduct the Say on Pay vote with its preferred frequency.

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However, as proposed, the rules will require companies to disclose in the 10-Q or 10-K immediately following the Say on Pay vote whether the company expects to conduct future Say on Pay votes with the frequency selected by the plurality of shareholder votes. Separate shareholder proposals on Say on Pay or Say on Pay frequency may be excluded from the proxy statement provided that the company's policy is consistent with plurality of votes cast in the most recent vote. Given the above, companies may have a strong incentive to structure the frequency of their Say on Pay votes in accordance with shareholder preferences.

The SEC recognizes that a vote with four choices will raise implementation challenges for companies, as shareholder voting typically follows a yes/no voting format. However, based on the way the Dodd-Frank rules were written, there was little room to interpret the rules as providing for anything other than four choices.

Finally, companies participating in TARP (which are required to conduct a Say on Pay vote annually) will not be required to conduct a vote on the frequency of the Say on Pay vote until the shareholder meeting immediately following the repayment of TARP funds.

## Highlights of the Guidance on Say on Parachutes

The SEC's proposed rules for new enhanced disclosure of golden parachute payments and an advisory vote on parachute payments state that the rules will be effective for proxy or consent solicitations to approve mergers or other transactions after the effective date of SEC amendment to disclosure rules (expected in the first quarter of 2011). This timing is later than expected and is helpful to companies as the new disclosure rules may be challenging to implement.

### *Disclosure of Golden Parachute Payments*

In response to Dodd-Frank's requirement of disclosure of golden parachute compensation in a "clear and simple form", the proposed rules will require a new compensation table covering golden parachute compensation to NEOs, including the following elements for each named executive officer:

- Cash severance payments
- Dollar value of accelerated stock awards, in-the-money value of options accelerated, and payments to cancel stock or options
- Pension and deferred compensation enhancements
- Perks and benefits
- Tax reimbursement and gross-up payments
- Other
- Total

Footnotes to the table will require disclosure of what payments are single trigger (triggered by change in control only) and double trigger (triggered by a change in control and termination of employment). In the tabular disclosure, equity will need to be valued based on the stock price as of the last practicable date before the proxy filing. The table will be accompanied by narrative disclosure of the timing of the payments and any conditions that would apply to payments, including covenants (e.g., non-compete, non-solicitation).

### *Say on Golden Parachute Payments*

The new rules require a separate non-binding shareholder advisory vote on golden parachute compensation, to the extent not previously subject to a prior general Say on Pay vote. In order to ensure that parachute payments are subject to the general Say on Pay vote, companies will have to disclose golden parachute compensation in their proxy statements with the new tabular disclosure and enhanced narrative disclosure of golden parachute payments.

It is not clear whether companies will decide to adopt the new disclosure in their proxy statements to ensure that they are subject to the general Say on Pay vote. While there will be some additional disclosure burden involved in providing the new tabular disclosure, many companies are already providing tabular disclosure of termination payments in their annual proxy statements. For these companies, it may be a simple exten-

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sion of their current disclosure to comply with the new requirements. In any case, disclosure in compliance with the new rules will be required in the merger proxy statement.

## Conclusion

The proposed rules have provided adequate clarity for companies to begin developing their Say on Pay and Say on Pay frequency resolutions. While the SEC is seeking comment on a number of aspects of the proposed rules, we expect the final rules to be largely consistent with the proposed rules. In developing the Say on Pay frequency resolution, we expect that most companies will state a preference for the frequency of the vote. Immediately following the passage of Dodd-Frank, our sense was that most companies would prefer biennial or triennial Say on Pay vote frequency; however, based on our discussions with clients we are seeing a trend toward a preference for an annual vote frequency.

The proposed rules for the Say on Golden Parachutes increase the disclosure requirements for companies, but will likely improve the quality of the disclosure from a shareholder's perspective. It will be interesting to see whether companies choose to voluntarily adopt the new disclosure requirements for golden parachute compensation in annual proxy statements to ensure that golden parachute compensation is subject to the general Say on Pay vote.

***Please contact us at (212) 921-9350 if you have any questions about the issues discussed above or would like to discuss your own executive compensation issues. You can access our website at www.capartners.com for more information on executive compensation.***

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