

SEC Issues Final “Say on Pay”, “Say on Frequency” and “Say on Golden Parachute” Rules

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On January 25, 2011, the Securities and Exchange Commission (“SEC”) issued final rules addressing the “say on pay,” “say on frequency” and “say on golden parachute” advisory votes required by Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The final rules become effective 60 days after they are published in the Federal Register.

- With limited exceptions, the “say on pay” and “say on frequency” votes must be included in any proxy statement filed with respect to an annual meeting occurring on or after January 21, 2011.
- Smaller reporting companies have been given a two-year reprieve and are not required to provide shareholders with a “say on pay” or “say on frequency” advisory vote until January 21, 2013, but are not exempt from providing shareholders with a “say on golden parachute” advisory vote in connection with a business combination.
- Disclosure of golden parachute arrangements and a “say on golden parachute” vote must be included in proxy materials seeking shareholder approval of a business combination filed on or after April 25, 2011.

The final rules generally follow the proposed rules released on October 25, 2010, with some important modifications, as noted below.

Say on Pay Vote

Section 14A(a)(1) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Rule 14a-21(a) require that each issuer include a resolution subject to a shareholder advisory vote to approve the compensation of its named executive officers (a “say on pay” vote) in 2011 and at least once every three calendar years thereafter.

The final rule clarifies that a say on pay vote must be included in a proxy statement for an annual meeting (or a special meeting in lieu of an annual meeting) for which proxies are solicited for the election of directors.

The say on pay vote must be a vote to approve the compensation of the named executive officers as disclosed in Item 402 of Regulation S-K, including the Compensation Discussion & Analysis (“CD&A”), compensation tables and other narrative disclosures required by Item 402. The final rule clarifies that a vote on a different subject (such as a vote to approve compensation policies and procedures) would not satisfy this requirement and includes an example of a shareholder resolution satisfying the SEC’s standard. Smaller reporting companies are not required to provide a CD&A in order to comply with the final rule.

The say on pay vote does not apply to the compensation of directors or to any compensation policies or practices relating to risk-taking incentives or risk management, except to the extent that such policies or practices are a material aspect of the compensation policies and decisions for named executive officers and warrant disclosure as part of the CD&A.

Under amended Item 24 of Schedule 14A, the proxy materials must also include a brief description of the effect of the say on pay vote, including whether it is non-binding. In addition, amended Item 24 requires disclosure of the current frequency of the say on pay vote and when the next say on pay vote will occur.

Under amended Item 402(b) of Regulation S-K, the CD&A must disclose whether, and if so, how, the results of the most recent say on pay vote were considered in determining executive compensation decisions and policies and how any such consideration affected compensation policies and decisions. The final rule limits this disclosure only to the most recent say on pay vote. The final rule also extends this requirement to issuers who are required to conduct an annual say on pay vote as a result of their participation in the Troubled Assets Relief Program (“TARP”). Since smaller reporting companies are not required to include a CD&A, they are also not required to provide disclosure about how previous say on pay votes affected compensation policies and decisions unless this disclosure would constitute a material factor necessary to understand the information contained in the smaller reporting company’s Summary Compensation Table.

Brokers do not have discretionary authority to vote customers’ shares in connection with a say on pay vote without receiving instructions.

Say on Frequency Vote

Section 14A(a)(2) of the Exchange Act and Rule 14a-21(a)(2) require that each issuer include a separate resolution subject to a shareholder advisory vote to determine the frequency with which a say on pay vote is to occur in 2011 and at least once every six calendar years thereafter (a “say on frequency” vote).

The final rule clarifies that a say on frequency vote must be included in a proxy statement for an annual meeting (or a special meeting in lieu of an annual meeting) for which proxies are solicited for the election of directors.

The say on frequency vote must be structured to provide shareholders with four choices: to elect that the say on pay vote occur every year or every two years or every three years or to abstain from voting on the matter. The final rules provide issuers with transitional relief through 2011, allowing proxy cards to include only the three substantive choices if proxy services are unable to accommodate the four required choices, as long as the issuer has no discretionary authority to vote proxies on the say on frequency if no choice has been selected by the shareholder.

Proxy cards may include a recommended alternative, but must provide shareholders with an opportunity to select from among all four choices rather than simply approve or disapprove a recommended alternative. The final rules clarify that issuers may vote proxy cards on which no choice is made in accordance with management’s recommendation only if the existing requirements of Rule 14a-4 are satisfied. However, brokers do not have

discretionary authority to vote customers' shares in connection with a say on frequency vote without receiving instructions.

- **Observation:** As of January 26, 2011, approximately 55% of issuers who have filed proxy statements including a say on frequency vote have recommended a triennial vote and 30% of issuers have recommended an annual vote. ISS's stated preference is for an annual vote.

Under amended Item 24 of Schedule 14A, the proxy materials must include a brief description of the general effect of the say on frequency vote, including whether it is non-binding.

Form 8-K has been amended to require that the preliminary and final results of the say on frequency vote be disclosed on Form 8-K in the same manner as any other shareholder vote. After considering the results of the say on frequency vote and making a determination regarding the frequency of future say on pay votes, the issuer must file an amended Form 8-K reflecting the issuer's decision within 150 calendar days after the end of the annual meeting (but no later than 60 days prior to the deadline for the submission of shareholder proposals for the subsequent annual meeting).

- **Observation:** This represents a significant departure from the proposed rules which required disclosure of the results of the say on frequency vote and the issuer's determination regarding the frequency of future say on pay votes in the Form 10-Q (or Form 10-K) covering the fiscal quarter in which the vote occurred.

Amended Rule 14a-8 permits issuers that implement a policy on the frequency of say on pay votes consistent with the majority of votes cast in the most recent say on frequency vote to exclude, as substantially implemented, shareholder proposals providing for a say on pay vote or a frequency vote.

- **Observation:** This exception is available only if both one choice receives a majority vote and the issuer implements this choice.

Common Issues Relating to Say on Pay Vote and Say on Frequency Vote

The final rules confirm that:

- Neither the say on pay vote nor the say on frequency vote requires the filing of preliminary proxy materials, including for issuers that voluntarily conduct a say on pay vote or a say on frequency vote.
- Brokers do not have discretionary authority to vote uninstructed shares with respect to a say on pay vote or a say on frequency vote.
- Issuers already required by TARP to conduct an annual say on pay vote remain exempt from requiring either a separate say on pay vote or say on frequency vote under new Rule 14a-21 until the issuer is no longer subject to the TARP annual say on pay voting requirement.

Disclosure of Golden Parachute Arrangements; Say on Golden Parachute Vote

Under Section 14A(b)(1) of the Exchange Act and Rule 14a-21(c), if a solicitation is made by an issuer for a meeting of shareholders at which shareholders are asked to approve an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all of the issuer's assets, the issuer must include

a separate resolution subject to a shareholder advisory vote to approve any agreements or understandings with any named executive officer concerning any compensation disclosed pursuant to Item 402(t) of Regulation S-K that is based on or relates to the transaction (“golden parachute arrangements”), unless such golden parachute arrangements have previously been the subject of a say on pay vote (a “say on golden parachute” vote).

Disclosure of golden parachute arrangements and the provision of a say on golden parachute advisory vote must be included in proxy materials filed on or after April 25, 2011.

Requirements as to Disclosure

Disclosure of golden parachute arrangements must be provided pursuant to new Item 402(t) of Regulation S-K with respect to proxy materials seeking shareholder approval of an acquisition, merger, consolidation, or proposed sale or disposition of all or substantially all of the issuer’s assets. Similar disclosure must also be provided in information statements required to be filed under Regulation 14C, going-private transactions under Rule 13e-3 and third-party tender offers, although third-party bidders in tender offers are not required to comply with the disclosure requirements.

Disclosure is required only with respect to golden parachute arrangements that are based on or otherwise relate to the specific transaction for which shareholder approval is being sought and must be provided in both tabular and narrative formats.

Item 402(t) of Regulation S-K mandates a new “Golden Parachute Compensation” table that: (1) separately identifies each individual element of the golden parachute compensation an executive officer would receive (e.g., cash severance payments [including base salary, bonus and pro-rata non-equity incentive compensation plan payments]; equity awards that are accelerated or cashed out; pension and nonqualified deferred compensation enhancements; perquisites, other personal benefits and health and welfare benefits; tax reimbursements, and other items); (2) provide an aggregate total of all golden parachute compensation; and (3) differentiate, by footnote, amounts attributable to “single trigger” and “double trigger” arrangements.

- ***Observation:*** Unlike other executive compensation disclosure rules (such as Item 402(j) of Regulation S-K governing disclosure of potential payments upon a change in control), which do not require disclosure of nondiscriminatory arrangements or de minimis perquisites and personal benefits, disclosure and quantification of the value of all golden parachute compensation related to the transaction is required under Item 402(t).

No separate disclosure would, however, be required with respect to previously vested equity awards, compensation that is already disclosed in the Pension Benefits Table and Nonqualified Deferred Compensation Table, or compensation from bona fide post-transaction employment agreements.

Disclosure would be required for golden parachute arrangements that either the target company or the acquiring company has or would have with the named executive officers of both the target company and the acquiring company. However, only golden parachute arrangements of the issuer seeking shareholder

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approval (typically, the target company) would be subject to the say on golden parachute vote.

Requirements as to the Say on Golden Parachute Vote

A say on golden parachute vote must be provided for in proxy materials seeking shareholder approval of an acquisition, merger, consolidation, or proposed sale or disposition of all or substantially all of the issuer's assets.

No specific form of resolution or specific language is mandated for the say on golden parachute vote; however, shareholders must be provided with all of the required Item 402(t) disclosures and be permitted to vote on the disclosed golden parachute arrangements which involve the executive officers of the issuer seeking shareholder approval of the related transaction.

No say on golden parachute vote would be required if the golden parachute arrangements were previously subject to a say on pay vote, provided that the shareholders were provided with all of the required Item 402(t) disclosures as part of the say on pay vote. To the extent that a new golden parachute arrangement is implemented after the most recent say on pay vote or an existing golden parachute arrangement is modified after the most recent say on pay vote, a separate say on golden parachute vote would be required. In such an event, a second table with respect to "Golden Parachute Compensation" would be required which would disclose only the new or revised golden parachute arrangements that are subject to the say on golden parachute vote. The final rule clarifies that changes to golden parachute arrangements that reduce the total amount of compensation payable do not require a new vote.

Conclusion

Issuers must prepare for the upcoming say and pay and say on frequency votes by considering:

- Whether to make a recommendation as to the frequency with which the say on pay vote will occur and what this frequency should be.
- How to most effectively communicate executive compensation decisions to shareholders, such as through an executive summary included in the CD&A or a supporting statement to the say on pay resolution.
- Whether to frame the say on pay and say on frequency votes as shareholder resolutions (particularly, if shareholder proposals typically are not included in proxy materials as resolutions), recognizing that in providing a sample resolution for a say on pay vote, the SEC has expressed a preference for resolutions.
- Whether to revise the Compensation Committee charter to reflect the role of the Compensation Committee in connection with the say on pay and say on frequency advisory votes, including oversight of the proxy statement disclosure accompanying the votes and review and consideration of the results of those votes.

This client alert is for general information purposes and should not be regarded as legal advice.