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ADVISORY | Securities

October 20, 2010

SEC PROPOSES SAY-ON-PAY RULES

Moving quickly to implement one of the higher-profile provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act), on October 18, 2010 the Securities and Exchange Commission (the SEC) proposed rules regarding shareholder advisory votes on executive compensation, often referred to as "say-on-pay" votes.[1] While most of this provision of the Act is self-executing, the SEC proposed rules to implement and clarify these new shareholder vote requirements. In addition, in a separate action, the SEC proposed rules to implement the requirement in the Act for institutional investment managers to report how they vote on these executive compensation shareholder advisory votes.[2] The following is a brief summary of the proposed rules.[3]

NEW SHAREHOLDER ADVISORY VOTES

Consistent with the Act, the SEC's proposal would add a new rule (Rule 14a-21 under the Exchange Act) to require public companies to provide their shareholders with advisory votes on (i) executive compensation, (ii) the desired frequency of votes on executive compensation, and (iii) golden parachute arrangements in connection with acquisitions, mergers, and similar transactions. The proposals would also require new disclosures about golden parachute arrangements in merger proxy statements and similar filings.

As provided by the Act, none of these shareholder votes would be binding on the company or its board of directors and none may be construed as overruling any decision of the company or its board of directors.[4] The Act also states that the shareholder votes may not be construed to restrict or limit the ability of shareholders to make proposals related to executive compensation for inclusion in the company's proxy materials.

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[1] *See* Rel. No. 33-9153 (Oct. 18, 2010) (the Proposing Release). The text of the proposed rules is included in the Proposing Release which is available on the SEC's website at http://sec.gov/rules/proposed/2010/33-9153.pdf. *See also* Section 951 of the Act, amending the Securities Exchange Act of 1934 (the Exchange Act) by adding new Section 14A.

[2] *See* Rel. No. 34-63123 (Oct. 18, 2010). The text of the proposed rules relating to reporting of votes by institutional investment managers is included in the release regarding such proposal which is available on the SEC's website at http://www.sec.gov/rules/proposed/2010/34-63123.pdf.

[3] The SEC has set a deadline of November 18, 2010 for submission of comments on the proposed rules. In addition to soliciting comments generally on the proposed rules, the SEC has asked for comment on a series of specific issues, including, for example, whether the scope of the new rules is sufficient and appropriate to implement the requirements of the Act, whether there should be a phase-in period for the new rules, and whether further disclosure should be required.

[4] Further, these shareholder votes may not be construed to create or imply any change to the fiduciary duties, or to create or imply any additional fiduciary duties, of the company or its board of directors.

Vote On Executive Compensation

Overview. Proposed new Rule 14a-21(a) would require a shareholder advisory vote, at least every three years, on the compensation paid to the company's named executive officers.[5] This vote would be provided in connection with the solicitation of proxies for an annual or other meeting of stockholders for which the SEC's proxy rules require disclosure of executive compensation under Item 402 of Regulation S-K, beginning with the first annual or other such shareholders' meeting taking place on or after January 21, 2011.

Because the vote generally relates to all disclosure under Item 402, it would cover the Compensation Discussion & Analysis (CD&A), the executive compensation tables, and the narrative accompanying such tables.[6] However, the proposed rules do not require the use of any specific language or form of resolution to be voted on by shareholders. Also, the proposed rules clarify that the shareholder vote will not cover compensation of directors, nor will it cover a company's compensation policies and practices as they relate to risk management and risk-taking incentives, to the extent such policies and practices are disclosed pursuant to Item 402(s).[7]

Amendment to CD&A Requirements. Although not required to do so by the Act, the SEC has proposed amending the CD&A disclosure requirements found in Item 402(b) of Regulation S-K. Specifically, the proposed rules would require the company to address whether and, if so, how the company has considered the results of previous say-on-pay votes and how that consideration has affected the company's compensation policies and decisions.[8] As proposed, this disclosure would be mandatory, as opposed to the existing "principles based" approach of Item 402(b), which lists a series of non-exclusive examples of issues that may merit discussion in the CD&A.

Frequency of Vote on Executive Compensation

Overview. Proposed new Rule 14a-21(b) would require public companies, at least every six years, to provide a separate shareholder advisory vote in proxy statements for annual meetings to determine whether the shareholder advisory vote on executive compensation should be held every year, every other year, or once every three years. Like the shareholder advisory vote on executive compensation, the advisory vote on the frequency issue will be required beginning with the first

[5] The "named executive officers" are the company's principal executive officer, principal financial officer, and the three other most highly paid executive officers during the most recent fiscal year.

[6] As proposed, Rule 14a-21 would not change the scaled disclosure requirements for smaller reporting companies. Accordingly, shareholder advisory votes for such companies, which are not required to include a CD&A in their proxy statement, would only cover compensation of the named executive officers as disclosed under Items 402(m) through 402(q) of Regulation S-K.

[7] However, to the extent a company's CD&A addresses such risk-related policies and practices, shareholders would have the opportunity to consider such matters when voting on executive compensation. *See* Proposing Release at 13.

[8] Smaller reporting companies, which need not provide a CD&A, would need to consider including this information in the narrative description of material factors necessary to an understanding of the summary compensation table, pursuant to Item 402(o) of Regulation S-K.

annual shareholders' meeting taking place on or after January 21, 2011.[9] Also like the say-on-pay vote, the SEC's proposal does not require any specific wording to be used for the vote.

Four Choices Requirement. Consistent with the requirements of the Act, the frequency vote would require that shareholders be given four choices: whether the shareholder vote on executive compensation will occur every one, two, or three years, or to abstain from voting on the matter.[10] The Proposing Release notes that the SEC would expect a company's board to include a recommendation as to how shareholders should vote, but indicates that the company must make it clear that there are four distinct choices and that the vote being requested is not to approve or disapprove the board's recommendation.[11]

Proposed Amendment to Rule 14a-8. The SEC has also proposed adding a note to Exchange Act Rule 14a-8(i)(10) to permit the exclusion under certain circumstances of a shareholder proposal seeking a say-on-pay vote or future say-on-pay votes, or that relates to the frequency of say-on-pay votes. Specifically, such a proposal may be deemed to be substantially implemented, and thus properly excluded from the company's proxy statement, if the company has already adopted a policy on the frequency of say-on-pay votes that is consistent with the plurality of votes cast in the most recent vote on the matter. This exclusion would apply regardless of whether the shareholder proposal seeks a different frequency than what has been implemented.[12]

Proposed Amendments to Form 10-K and Form 10-Q. The SEC has proposed amendments to Form 10-K and Form 10-Q to require disclosure of how frequently the company will conduct shareholder advisory votes on executive compensation in light of the results of the shareholder vote on frequency. This disclosure would be required in the Form 10-Q covering the period during which the vote occurs (or in the Form 10-K if the vote occurs during the company's fourth quarter).

Proposals Applying to Both Say-on-Pay and Frequency of Say-on-Pay Votes

The SEC addressed several issues in its proposed rules that relate to both the say-on-pay vote and the frequency of the say-on-pay vote, as follows:

- **No Preliminary Filing Trigger.** The proposed rules would amend Exchange Act Rule 14a-6(a) so that proxy statements including a solicitation relating to either a say-on-pay vote or the frequency of the say-on-pay vote would not trigger the filing of a preliminary proxy statement.
- **Proxy Statement Disclosure.** The SEC has proposed to add Item 24 to Schedule 14A, which would require companies to disclose in a proxy statement that they are providing a separate shareholder vote on executive compensation and/or the frequency of the shareholder advisory

[9] As with the say-on-pay vote, the Proposing Release states the SEC's view that this "frequency" vote will only be required with respect to an annual meeting of shareholders for which proxies will be solicited for the election of directors, or a special meeting in lieu of such annual meeting. *See* Proposing Release at 19 (f.n. 59).

[10] Accordingly, the SEC is proposing to modify Exchange Act Rule 14a-4 to permit forms of proxies to reflect these four choices.

[11] The SEC is seeking specific comment on whether the four choices will be sufficiently clear and whether issuers, brokers, transfer agents, and data processing firms will be able to accommodate the four choices for a single line items on the proxy card.

[12] A company relying on this note to exclude a shareholder proposal would also need to hold a "frequency" vote at least once every six years, as required by the Act and proposed new Rule 14a-21(b).

vote on executive compensation, as required by Section 14A of the Exchange Act, and to briefly explain the general effect of the vote, such as whether the vote is non-binding.

- **Broker Discretionary Voting.** Under the amended rules of the national securities exchanges, as required by Section 957 of the Act, broker discretionary voting of uninstructed shares is not permitted for a say-on-pay vote or a vote on the frequency of a say-on-pay vote.
- **TARP Companies.** The say-on-pay vote required to be conducted by companies that have received assistance under the Troubled Asset Relief Program (TARP) would satisfy the requirements under the new rules described above, and TARP recipients that already conduct an annual shareholder vote to approve executive compensation would not be required to conduct a separate vote under the proposed new rules until they have repaid all TARP obligations. These companies are also provided an exemption from conducting a vote on the frequency of the say-on-pay vote until such time.

Golden Parachute Disclosures and Advisory Votes

Overview. As required by the Act, the SEC's proposed rules would require public companies, in connection with proxy or consent solicitations relating to merger, acquisition, or similar transactions (including going private transactions and third-party tender offers), to provide shareholders with specific disclosures about, and a separate non-binding vote on, "golden parachute" compensation arrangements.

New Item 402(t) of Regulation S-K. Rather than amending the existing compensation disclosure item requiring disclosure of payments upon termination or change in control,[13] the proposed rules would add new Item 402(t) to Regulation S-K, which would require specified tabular and narrative disclosures regarding all "golden parachute" compensation based on or relating to an acquisition, merger, or similar transaction, pursuant to any arrangement between or among the target and acquiring companies and the named executive officers of each. Golden parachute compensation, for purposes of proposed Item 402(t), includes any type of compensation (whether present, deferred, or contingent) that is based on or related to the merger or acquisition transaction.

The golden parachute disclosure contemplated by Item 402(t) would be required to be included in any proxy or consent solicitation material seeking approval of an acquisition, merger, consolidation, or proposed sale or other distribution of all or substantially all the assets of the company. In addition, as noted below, companies would be permitted to include the Item 402(t) information voluntarily in their annual meeting proxy statements.[14]

Item 402(t) would require tabular presentation of the dollar amounts of individual elements of golden parachute compensation, including cash severance, the value of accelerated equity awards and payments in cancellation of equity awards, the value of pension and nonqualified deferred compensation benefit enhancements, perquisites and other personal benefits such as health care and welfare benefits, tax reimbursements, and other compensation. The Proposing Release makes clear that, in order to be disclosed in this new table, compensation must be based on or related to the transaction in question. Thus, the SEC notes that separate disclosure or quantification with

[13] *See* Item 402(j) of Regulation S-K.

[14] If a company includes Item 402(t) disclosure in the proxy statement for its annual meeting, the value of equity awards would be calculated using the closing market price as of the last business day of the company's last completed fiscal year. Where the Item 402(t) information is disclosed in a merger proxy statement, however, the value of equity awards would be calculated using the closing market price as of the latest practicable date.

respect to compensation disclosed in the pension benefits table and nonqualified deferred compensation table should not be required, although enhancements or acceleration of vesting of such benefits would need to be disclosed.[15] Similarly, the SEC notes that the new table would not require disclosure of previously-vested equity awards, since these amounts are not based on the transaction.[16]

The columns in the table required by proposed Item 402(t) would have to be footnoted to quantify each separate form of compensation in the aggregate amount reported in that column. In addition, amounts attributable to single-trigger and double-trigger arrangements would need to be separately quantified by footnote.

Item 402(t) would also require a description of any material conditions or obligations applicable to the payments, such as non-compete, non-solicitation, non-disparagement, or confidentiality agreements, their duration and provisions regarding waiver or breach. Disclosure of any specific payment triggers would also be required.

Other Filings Requiring Item 402(t) Disclosure. Although not specifically required by the Act, the SEC has proposed to require Item 402(t) disclosure in the following filings:

- 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 (such as a solicitation of proxies to approve the issuance of shares or a reverse stock split in order to conduct a merger transaction);
- registration statements on Forms S-4 and F-4 containing disclosure relating to mergers and similar transactions;
- going private transactions on Schedule 13E-3; and
- third-party tender offers on Schedule TO and Schedule 14D-9 solicitation/recommendation statements.[17]

Vote on Golden Parachutes. Proposed Rule 14a-21(c) would require a company to provide its shareholders an advisory vote at any shareholder meeting at which shareholders are asked to approve an acquisition, merger, or similar transaction to approve any golden parachute arrangements disclosed pursuant to Item 402(t). As proposed, this vote would only need to cover arrangements between the registrant seeking the shareholder vote and its named executive officers, even though Item 402(t) would require more extensive disclosure, including arrangements between both the acquiring company or the target company and the named executive officers of either company.

Exception to Separate Merger Proxy Shareholder Vote. A company need not conduct a separate merger proxy shareholder vote on golden parachute arrangements if it included the disclosure called for by Item 402(t) in a previous annual meeting proxy statement that solicited a say-on-pay vote, whether or not such compensation arrangements were approved by the shareholders. This

[15] *See* Proposing Release at 45.

[16] The SEC also noted that the Item 402(t) table would not require disclosure of bona fide post-transaction employment agreements or other future employment arrangements.

[17] In the case of a third-party tender offer, the bidder would be required to provide information in its Schedule TO about a target's golden parachute arrangements but only to the extent the bidder has made a reasonable inquiry about the golden parachute arrangements and has knowledge of such arrangements.

exception is only available, however, if there have been no modifications to the golden parachute arrangements that were disclosed in the previous annual meeting proxy statement. Some companies can be expected to voluntarily include Item 402(t) disclosure with their other executive compensation disclosure in annual meeting proxy statements soliciting a say-on-pay vote, in order to avail themselves of this exception in the event of a subsequent merger or acquisition transaction.

In cases where golden parachute arrangements are disclosed in an annual meeting proxy statement pursuant to Item 402(t), but then such arrangements are modified after the annual meeting say-on-pay vote, the proposed rules require that only the new arrangements and revised terms of the arrangements be subject to a subsequent shareholder advisory vote. In this circumstance, where a company provides a vote on new or revised golden parachute arrangements, the company must provide two separate tables under Item 402(t) in its merger proxy statement: one table would disclose all golden parachute compensation, and the other table would disclose only the new or revised arrangements subject to the vote.

REPORTING OF SAY-ON-PAY VOTES BY INSTITUTIONAL INVESTMENT MANAGERS

The SEC has also proposed rules requiring institutional investment managers required to file reports under Section 13(f) of the Exchange Act to report their votes on say-on-pay, frequency of say-on-pay, and golden parachute arrangements at least annually, unless the votes are otherwise required to be reported publicly by SEC rules.[18] Generally, this applies to every institutional investment manager that manages certain equity securities having an aggregate fair market value of at least $100 million.

Specifically, institutional investment managers would be required to file their record of votes with the SEC on Form N-PX no later than August 31 of each year, for the previous 12 months ending June 30. The manager would be required to identify the securities voted, describe the matters voted on, disclose the number of shares over which the manager held voting power and the number and shares voted, and indicate how the shares were voted.

TIMING AND TRANSITION

Because the Act's requirements for shareholder advisory votes on executive compensation and the frequency of say-on-pay votes are self-effectuating, proxy statements for shareholder meetings taking place on or after January 21, 2011 must include such votes, even if the proposed rules have not been adopted by the SEC by that time.[19] On the other hand, the new disclosure requirements with respect to golden parachute arrangements, and the separate shareholder vote on such arrangements, will not be required for shareholder meetings taking place on or after January 21, 2011 until such time as the proposed rules are adopted by the SEC.

Given the tight timetable, there will be some uncertainty for those companies that must distribute proxy materials prior to the adoption of final say-on-pay rules by the SEC. The SEC has sought to address some of this potential uncertainty in the Proposing Release. Specifically, the SEC has stated that, as a transitionary matter until final rules are promulgated, the SEC will not object if:

- a company does not file proxy materials in preliminary form where the only matters in the proxy materials requiring a preliminary filing are the say-on-pay vote and the frequency of the say-on-pay vote;

[18] *See* proposed Exchange Act Rule 14A(d) and SEC Rel. No. 34-63123.

[19] Proposing Release at 9.

- the form of proxy for a shareholder vote on the frequency of say-on-pay votes provides for a choice among one, two, or three years or abstention, although the rules currently require the choice of approval, disapproval, or abstention; or
- an issuer with outstanding obligations under the TARP does not include a resolution for a shareholder advisory vote on the frequency of say-on-pay votes in its proxy statement.

In addition, the SEC has indicated that during this transition period it will not object if shareholders are only given a choice among one, two, or three years for the vote on frequency of say-on-pay votes (omitting the abstention option), if proxy service providers are not able to adequately reprogram their systems to accommodate the four required choices.[20] Issuers using this approach, however, may not exercise voting discretion with respect to the frequency of say-on-pay vote in returned but unmarked proxies, which may make this an undesirable option because it means that such proxies cannot be voted in favor of management's recommendation with respect to the frequency of say-on-pay vote.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our securities practice group:

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[20] This accommodation is needed due to the fact that most service providers in the proxy distribution process have indicated that it will be very difficult for them to change their systems in order to accommodate the four choices required by these proposed rules. These difficulties are attributable to the fact that most systems for proxy processing and tabulation are set up to accept three choices, and adding a fourth choice will require a substantial overhaul of those systems. While it is likely that these issues will be resolved in time for the spring 2011 proxy season, they are unlikely to be resolved by early December when some companies will have to file their proxy materials.