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ADVISORY | Securities

January 26, 2011

SEC ADOPTS SAY-ON-PAY RULES

Just in time for the spring proxy season, yesterday the Securities and Exchange Commission (the SEC) adopted, by a 3-2 vote, final rules regarding shareholder advisory votes on executive compensation, often referred to as "say-on-pay" votes.[1] These rules implement one of the higher-profile provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act).[2] Although the rules generally take effect 60 days after publication in the Federal Register, companies holding annual meetings after January 21, 2011 must comply with the Act's requirements to hold shareholder advisory votes on executive compensation and the frequency of such votes, because those provisions of the Act are self-executing.[3] The following is a brief summary of the new rules.

KEY CHANGES FROM THE PROPOSED RULES

In response to comments, the SEC made some important modifications to the proposed rules, as highlighted below and as further discussed in this advisory.

- Smaller reporting companies need not comply with the rules requiring shareholder advisory votes on executive compensation or the frequency of such votes until their first shareholder meetings on or after January 21, 2013.
- Rule 14a-21(a), requiring a shareholder advisory vote on executive compensation, now includes a non-exclusive example of a shareholder resolution that may be used for such vote.
- The company's decision in light of the results of the advisory vote on the frequency of say-on-pay votes must be reported under Item 5.07 of Form 8-K, rather than on Forms 10-Q or 10-K as proposed, and such disclosure generally will not be required to be reported until 150 days after the shareholder meeting.
- Companies may exclude shareholder proposals under Rule 14a-8(i)(10) that seek advisory votes on certain executive compensation matters if the company has adopted a policy regarding the frequency of say-on-pay votes that is consistent with a *majority* of votes cast in the most recent shareholder vote on the matter, as opposed to the plurality standard initially proposed.
- In a departure from the proposed rules, disclosure regarding golden parachutes is not required to be provided by third party bidders using Schedule TO.

[1] *See* Rel. No. 33-9178 (Jan. 25, 2011) (the Adopting Release). The text of the final rules is included in the Adopting Release which is available on the SEC's website at http://sec.gov/rules/final/2011/33-9178.pdf.

[2] Section 951 of the Act, containing the Act's say-on-pay provisions, amended the Securities Exchange Act of 1934 (the Exchange Act) by adding new Section 14A. Section 951 also requires institutional investment managers to report their say-on-pay votes, and the SEC's proposed rules implementing this requirement are still pending. *See* Rel. No. 34-63123 (Oct. 18, 2010).

[3] Compliance with the new rules regarding disclosure of, and shareholder advisory votes on, golden parachute arrangements is first required for proxy statements and other filings made on or after April 25, 2011.

NEW SHAREHOLDER ADVISORY VOTES

Consistent with the Act, new Rule 14a-21 requires public companies to provide their shareholders with advisory votes on (i) executive compensation, (ii) the frequency of votes on executive compensation, and (iii) golden parachute arrangements in connection with acquisitions, mergers, and similar transactions. The new rule also requires disclosures about golden parachute arrangements in merger proxy statements and similar filings. As provided by the Act, none of these shareholder votes are 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]

Vote On Executive Compensation

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

The vote is to cover all executive compensation disclosed under Item 402, including the Compensation Discussion & Analysis (CD&A), the executive compensation tables, and the narrative accompanying such tables.[6] Although the new rule does not require the use of any specific language or form of resolution to be voted on by shareholders, the SEC decided to add an instruction to Rule 14a-21(a) to provide a non-exclusive example of a resolution that satisfies the requirements of the rule, as follows:

> 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 new rule clarifies that the shareholder vote does not cover compensation of directors, nor does 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. Although not required to do so by the Act, the SEC amended the CD&A disclosure requirements found in Item 402(b) of Regulation S-K. Specifically, companies will now be

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[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.

[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] Rule 14a-21 does not change the scaled disclosure requirements for smaller reporting companies, which are not required to include a CD&A in their proxy statement. Accordingly, once smaller reporting companies are required to comply with the new rules, shareholder advisory votes for such companies 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* Adopting Release at 18.

required to address whether and, if so, how they have considered the results of the most recent say-on-pay vote and how that consideration has affected the company's compensation policies and decisions.[8] The SEC indicated in the Adopting Release that it considers this new element of CD&A to be a mandatory topic for discussion, in contrast to the "principles based" approach of the rest of Item 402(b), which lists a series of non-exclusive examples of issues that may merit discussion in the CD&A. The SEC also noted that, consistent with such principles-based approach, companies should address their consideration of the results of say-on-pay votes occurring prior to the most recent say-on-pay vote, to the extent material.[9]

Frequency of Vote on Executive Compensation

Overview. New Rule 14a-21(b) requires public companies, at least every six years, to provide a separate shareholder advisory vote at 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 is required beginning with the first annual shareholders' meeting on or after January 21, 2011.[10] The rule does not require any specific wording to be used for the vote, and, unlike the shareholder advisory vote on executive compensation, the SEC declined to provide an example of a resolution that would satisfy the requirements of the rule.

Four Choices Requirement. Consistent with the requirements of the Act, the frequency vote requires 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.[11] Although a company's board would be expected to include a recommendation as to how shareholders should vote, the proxy materials must be clear that there are four distinct choices and that the vote being requested is not to approve or disapprove the board's recommendation. However, the Adopting Release confirms that companies may vote uninstructed proxy cards in accordance with management's recommendation for the frequency vote as long as the company follows the existing requirements of Rule 14a-4 to (i) include a recommendation for the frequency of say-on-pay votes in the proxy statement, (ii) permit abstention on the proxy card, and (iii) include language regarding how uninstructed shares will be voted in bold on the proxy card.[12]

New Note to Rule 14a-8. A new note has been added to Rule 14a-8(i)(10) that will permit companies to exclude under certain circumstances 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 properly excluded from the company's proxy statement if the company has adopted a policy on the frequency of say-on-pay votes that is consistent with the majority of votes cast in the most recent shareholder vote on the matter. This varies from the proposed rule, which would have only required the company to adopt a policy consistent with a plurality of votes cast. The company

[8] The SEC did not impose additional specific requirements on smaller reporting companies, which need not provide a CD&A, but such companies 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. *See* Adopting Release at 23.

[9] *See* Adopting Release at 28.

[10] As with the say-on-pay vote, the frequency vote will only be required at annual or other meetings of shareholders at which directors will be elected. *See* Adopting Release at 32.

[11] The SEC approved a modification to Rule 14a-4 to permit forms of proxies to reflect these four choices.

[12] *See* Adopting Release at 37.

may rely on this note to exclude a shareholder proposal regardless of whether the proposal seeks a different frequency than what has been implemented.[13]

Reporting Results of Frequency Vote on Form 8-K. The SEC has amended Form 8-K to require disclosure, under Item 5.07, of the results of the shareholder advisory vote on the frequency of say-on-pay votes and how frequently the company will conduct such shareholder advisory votes on executive compensation in light of such results.[14] The decision of the company in light of the results of the vote on the frequency of say-on-pay votes is required to be reported, by means of an amendment to the initial Form 8-K reporting the other results of the shareholders meeting, no later than 150 calendar days after the date of the annual meeting at which the vote took place, but in no event later than 60 calendar days prior to the deadline for the submission of shareholder proposals for the subsequent annual meeting.[15]

Items Relevant to Both Say-on-Pay and Frequency of Say-on-Pay Votes

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

- **No Preliminary Proxy Filing.** Rule 14a-6(a) was amended to provide that a preliminary proxy statement need not be filed if the solicitation relates to a required shareholder advisory vote on executive compensation or the frequency of the say-on-pay vote, or any other shareholder advisory vote on executive compensation.
- **Proxy Statement Disclosure.** The SEC has added Item 24 to Schedule 14A, requiring companies to (i) disclose in a proxy statement that they are providing a separate shareholder vote on executive compensation and/or the frequency of the shareholder advisory vote on executive compensation, as required by Section 14A of the Exchange Act, (ii) briefly explain the general effect of the vote, such as whether the vote is non-binding, and (iii) when applicable, disclose the current frequency of shareholder advisory votes on executive compensation and when the next such vote will occur.[16]
- **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) will 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 new rules until they have repaid all TARP obligations. These companies

[13] 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 new Rule 14a-21(b).

[14] This approach differs from the proposed rules, which would have required such disclosure in the Form 10-Q or Form 10-K filed after the end of the quarter in which the shareholder vote took place.

[15] Companies will be required to report the preliminary results of the shareholder advisory vote on executive compensation and the frequency of votes on executive compensation within four business days of the end of the shareholders meeting. *See* Instruction 1 to Item 5.07 of Form 8-K.

[16] The Adopting Release confirms that the disclosure referenced in clause (iii) regarding the current frequency of shareholder advisory votes, would not be expected to be included in a company's proxy statement relating to the first shareholder advisory votes under the new rules. *See* Adopting Release at 34, f.n. 119.

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 new rules require public companies, in connection with proxy or consent solicitations and certain other filings relating to merger, acquisition, or similar transactions (including going private transactions), 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. New Item 402(t) of Regulation S-K requires, in the context of proxy or consent solicitations and certain other filings relating to merger or similar transactions, 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 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 required by Item 402(t) must 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. However, in a departure from the proposed rules, the new rules do not require bidders in third-party tender offers to provide such disclosure in Schedule TO, as long as the transaction is not also a going-private transaction under Rule 13e-3. Companies filing solicitation/recommendation statements on Schedule 14D-9 in connection with third-party tender offers, though, will be obligated to provide the Item 402(t) disclosure.[17] In addition, as noted below, companies are permitted to include the Item 402(t) information voluntarily in their annual meeting proxy statements.[18]

Item 402(t) requires 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. 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 respect to compensation disclosed in the pension benefits table and nonqualified deferred compensation table is not required, although enhancements or acceleration of vesting of such benefits would need to be disclosed.[19] Similarly,

[17] *See* Adopting Release at 77, fn. 261.

[18] 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 consideration per share, if such value is a fixed dollar amount, or otherwise the average closing price per share over the first five business days following the first public announcement of the transaction.

[19] *See* Adopting Release at 71.

the SEC notes that the new table does not require disclosure of previously-vested equity awards, since these amounts are not based on the transaction.[20]

The columns in the table required by Item 402(t) 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 need to be separately quantified by footnote.

Item 402(t) also requires 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 is also required.

Other Filings Requiring Item 402(t) Disclosure. Although not specifically required by the Act, the SEC is requiring 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
- Schedule 14D-9 solicitation/recommendation statements.

Vote on Golden Parachutes. Rule 14a-21(c) requires 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). This vote only needs 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 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.

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

[20] 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.

revised arrangements subject to the vote. However, changes that result only in a reduction in value of the total compensation payable are not required to be subject to a new shareholder vote.

TIMING AND TRANSITION

Smaller Reporting Companies. The SEC voted to delay compliance for smaller reporting companies with respect to the shareholder advisory vote on executive compensation required by new Rule 14a-21(a) and the frequency vote required by new Rule 14a-21(b).[21] Under this accommodation, smaller reporting companies will not be required to hold such votes until the first annual or other shareholders meeting taking place on or after January 21, 2013. However, smaller reporting companies are not exempt from compliance with the new requirements relating to disclosure of, and shareholder advisory vote on, golden parachutes.

Other Timing and Transition Issues. Because the Act's requirements for shareholder advisory votes on executive compensation and the frequency of say-on-pay votes are self-executing, proxy statements for shareholder meetings taking place on or after January 21, 2011 must include such votes, even though the SEC's rules generally will not be effective until 60 days after their publication in the Federal Register. However, the new disclosure requirements with respect to golden parachute arrangements, and the separate shareholder vote on such arrangements, will only apply to proxy statements and other filings that must include such disclosures made on or after April 25, 2011.

Because companies must comply with the self-executing provisions of the Act, the SEC has extended its transition positions set forth in the release issued with the proposed rules until the new rules become effective. Specifically, 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;
- 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 indicated in the Adopting Release that, for proxy material filed for meetings to be held on or before December 31, 2011, 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.[22] 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.

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[21] Smaller reporting companies are generally public companies with a public float of less than $75 million. *See* Rule 12b-2 under the Exchange Act.

[22] 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.

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