SEC Finalizes
Say-on-Pay Rules

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SEC FINALIZES SAY-ON-PAY RULES

The SEC has adopted final rules implementing the shareholder advisory votes on executive compensation required by Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) enacted in July 2010. Section 951 requires that public companies allow for three types of shareholder advisory (i.e., non-binding) votes on executive compensation:

1. A **say-on-pay vote** on whether to approve the company’s compensation for its named executive officers as disclosed, pursuant to the SEC’s executive compensation disclosure standards (Item 402 of Regulation S-K). The vote must be held at least once every three years.

2. A **say-on-frequency vote** on whether to hold the say-on-pay vote every one, two or three years. The say-on-frequency vote must be held at least once every six years.

3. A **“golden parachute” vote** in connection with merger, acquisition or similar extraordinary business transactions. A company that solicits a proxy with respect to such a transaction must disclose any “golden parachute” arrangements between it and its named executive officers, or between it and the named executive officers of the acquiring company, if the company soliciting the merger proxy is not the acquiring company. Unless those golden parachute arrangements had already been subject to a say-on-pay vote, the company must give shareholders a non-binding vote on whether to approve the golden parachute arrangements with a company’s named executive officers.

The final rules differ in certain respects from the SEC’s proposed rules. The following highlights the requirements of the final rules, and notes certain relevant changes from the proposed rules.

**General Highlights of Final Rules**

- **All Public Companies Impacted.** The final rules provide that all public companies must comply with all of the Section 951 requirements. There is a two-year delayed implementation of the say-on-pay and say-on-frequency vote requirements for smaller reporting companies (i.e., those with a public float of less than $75 million). Non-public companies are not affected by these rules.

- **Effective Date for Say-on-Pay and Say-on-Frequency.** Shareholder resolutions for the say-on-pay and say-on-frequency votes must be included in a public company’s proxy solicitation materials for its first annual shareholders meeting occurring on or after Jan. 21, 2011, (except for smaller reporting companies, as noted below). Companies must comply with this effective date requirement even though the final say-on-pay and say-on-
frequency do not take effect until 60 days after the final rules are published. As a result, the final rules on these two votes technically will not be effective for many proxy statements filed this year. However, the final rules contain transition guidance that permit companies to utilize certain aspects of the final rules before they take effect.

- **Delayed Implementation for Smaller Reporting Companies.** The final rules provide that smaller reporting companies are not required to hold say-on-pay or say-on-frequency votes until the first shareholder meeting occurring on or after Jan. 21, 2013. Many commentators had hoped for a permanent exception. The final rules clarify that this delayed implementation for smaller reporting companies does not apply to the golden parachute-related requirements.

- **Golden Parachute Effective Date.** The rules concerning votes on golden parachute arrangements are effective for merger proxy statements and similar filings (as discussed below) made after April 25, 2011. All public companies must comply with these rules after April 25, 2011.

- **Voting Disclosure Requirements.** Companies are required to disclose in the proxy statement that separate say-on-pay and say-on-frequency votes are being provided, and briefly explain the nature of each vote, including that it is non-binding. In addition, the final rules clarify that issuers must disclose the current frequency of the say-on-pay votes and when the next say-on-pay vote will occur. However, the final rules do not provide any specific language that must be used to explain to shareholders any of the three votes.

- **Rules Impact Other Disclosure Requirements.** In addition to implementing the new voting requirements, the final rules also impose new requirements with respect to certain other disclosure requirements. For example, companies must address in the compensation discussion and analysis (CD&A) section of next year’s proxy statement, whether and how the company considered the results of the prior year’s say-on-pay vote in setting compensation, as discussed further below.

- **No Preliminary Proxy Required.** The final rules clarify that all shareholder advisory votes on executive compensation, including the say-on-pay and say-on-frequency votes, do not require the filing of a preliminary proxy with the SEC.

- **No Broker Discretionary Voting.** The final rules confirm, in accordance with amendments to listing standards that the national securities exchanges have already begun to adopt, that brokers may not vote uninstructed shares on executive compensation matters, including the say-on-pay and say-on-frequency votes. Brokers are already prohibited from voting uninstructed shares on matters (including the say-on-golden-parachute vote) in connection with merger or acquisition transactions.

- **TARP Companies Exempt from Say-on-Frequency Vote.** Because financial institutions that participate in TARP are already subject to an annual non-binding shareholder vote on executive compensation, the final rules confirm that these companies, for as long as they remain in TARP, are not required to provide the say-on-frequency vote.
Say-on-Pay Rules

The final rules implement the say-on-pay vote as follows:

- The vote must be a separate shareholder resolution. The vote must cover all executive compensation disclosed pursuant to Item 402 of Regulation S-K, including the CD&A, the Summary Compensation Table, and the related tables and narrative sections.
- While the final rule does not require any specific language for a resolution, the rule does require that the resolution state that the vote is to approve the compensation of the registrant’s named executive officers “as disclosed pursuant to Item 402 of Regulation S-K.” The SEC provides a one-sentence example of a resolution that would satisfy the requirements.
- The vote is required when there is an annual meeting of shareholders at which proxies are solicited for the election of directors.
- The vote is required at least once every three calendar years, even if that results in votes being held more than three years apart. For example, the first vote could occur on May 1, 2011, and the next vote could be on May 15, 2014.
- As mentioned above, there is a two-year temporary exemption for smaller reporting companies. When the rules become effective for these companies, the vote will cover only the executive compensation that is required to be reported in the proxy. Currently, smaller reporting companies are not required to include a CD&A. They will not have to have a CD&A to comply with the say-on-pay vote.
- The company’s compensation-related risk management policies, as required to be disclosed pursuant to Item 402(s) of Regulation S-K, are not covered by the vote. To the extent risk management disclosure is included or incorporated in the CD&A as a material aspect of executive compensation, however, the say-on-pay vote will cover those policies and practices on risk management.
- Going forward, companies must include in their CD&As a mandatory discussion of whether, and if so, how their compensation decisions and policies have taken into account the results of the most recent say-on-pay vote. This does not apply to smaller reporting companies.
- The vote does not cover non-employee director compensation disclosed in the proxy.

Say-on-Frequency Rules

The final rules implement the say-on-frequency vote as follows:
• The non-binding say-on-frequency vote is required at least once during the six calendar years following the prior vote, similar to the clarification made for the timing of the say-on-pay vote.

• Shareholders must be given four choices: whether the say-on-pay vote will occur every (1) one, (2) two, or (3) three years, or (4) to abstain from voting. Companies may include a recommendation on the frequency, as long as shareholders are presented with all four choices.

• Companies able to accommodate the four choices outlined above may vote uninstructed proxy cards in accordance with management’s recommendation if they (1) include a recommendation for the say-on-frequency vote in the proxy statement; (2) permit abstention on the proxy card; and (3) include language regarding how uninstructed shares will be voted in bold on the proxy card. For meetings held on or before Dec. 31, 2011, companies whose proxy service providers cannot provide shareholders with four choices may include a vote for one, two, or three years; however, they may not vote shares in the event the person solicited does not select a choice.

• A company’s decision as to how frequently if will offer say-on-pay voting must be reported on a Form 8-K that amends the Form 8-K which was filed to report the results of the matters voted on during a shareholder meeting. The amended Form 8-K must be filed no later than 150 calendar days after the meeting, but in no event later than 60 days prior to deadline for submission of shareholder proposals.

• Companies that adopt a policy to hold the say-on-pay vote in accordance with the frequency selected by a majority of the votes cast, may exclude any subsequent shareholder proposal seeking a different frequency for the say-on-pay vote on the basis that such proposal has been “substantially implemented.” The proposed rules would have permitted exclusion based the option that received the support of a plurality of votes cast. The final rules also permit the exclusion of shareholder proposals concerning advisory votes on executive compensation with substantially the same scope as the say-on-pay vote, if the frequency policy is consistent with the majority of votes cast.

Golden Parachute Disclosure Rules

The final rules implement the golden parachute disclosure rules as follows:

• The disclosure is only required in merger proxies or other similar filings, not in annual proxies. However, public companies may provide the disclosure in annual proxies if they choose (see additional discussion below). The person required to provide the disclosure is the person soliciting the proxy (usually the target company in a merger).

• The disclosure only applies to “golden parachute” arrangements. For this purpose, “golden parachute” arrangements mean any arrangements concerning compensation that is based on or otherwise related to the merger or similar transaction, including accelerated vesting of equity awards and
enhanced pension or nonqualified deferred compensation benefits, but excluding previously vested equity awards, compensation previously disclosed in the Pension Benefits or Nonqualified Deferred Compensation tables, and compensation from bona-fide post-transaction employment agreements. The final rules clarify that the disclosure is only required with respect to golden parachute compensation that is actually triggered by the subject transaction.

- The disclosure applies to golden parachute arrangements between either the target or the acquiring company on one hand, and the named executive officers (NEOs) of either the target company or the acquiring company on the other. Thus, arrangements between (i) the target company and the target company’s NEOs, (ii) the acquiring company and the acquiring company’s NEOs, (iii) the acquiring company and the target company’s NEOs, and (iv) in unusual cases, the target company and the acquiring company’s NEOs, are all covered. The final rules confirm that disclosure is not required for golden parachute arrangements with any NEO, other than a former PEO or PFO, who was not serving as an executive officer as of the last day of the prior fiscal year.

- Tabular and narrative disclosure is required. Tabular disclosure must be quantitative and presented in the following form:

<table>
<thead>
<tr>
<th>Name (a)</th>
<th>Cash ($) (b)</th>
<th>Equity ($) (c)</th>
<th>Pension/ NQDC ($) (d)</th>
<th>Perquisite Benefits ($) (e)</th>
<th>Tax Reimbursement ($) (f)</th>
<th>Other ($) (g)</th>
<th>Total ($) (h)</th>
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<tbody>
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<td>PEO</td>
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</table>

- The final rules clarify that the table may be expanded or modified to take into account an issuer’s particular circumstances, as long as the presentation contains all required information and is not misleading.

- Footnotes to the table must identify and quantify (i) each separate form of compensation included in each column (other than the “total” column), and (ii) amounts payable under “single-trigger” arrangements vs. amounts payable under “double-trigger” arrangements included in each column (including the “total” column). In contrast to annual proxy reporting requirements, all perquisites (including perquisites with an aggregate incremental value less than $10,000) must be reported, as must the value of all health and welfare plan benefits (including benefits under plans that do not discriminate in favor of executive officers).
In a departure from the proposed rules, for disclosures in transactional filings, the value of accelerated equity awards reported in the table is determined based on either the deal price or the average stock price over the preceding five days. For disclosures in annual proxy filings, the value of equity awards continues to be reported based on the last day of the prior fiscal year.

- The narrative disclosure must describe any material conditions or obligations applicable to golden parachute payments (i.e., restrictive covenant agreements), specific circumstances that trigger payment, the form and source of those payments, and any other material factors concerning each agreement.

- The disclosure rules apply not only to merger proxies solicited for a merger or similar transaction, but generally to any filing relating to such transactions, including registration statements containing disclosures relating to such transactions and filings for going private transactions. In a departure from the proposed rules, the final rules clarify that a bidder in a third-party tender offer is not required to make the disclosure.

**Say-on-Golden-Parachute Rules**

The final rules implement the say-on-golden-parachute vote requirements as follows:

- The non-binding say-on-golden-parachute vote is required only in connection with golden parachute disclosure in merger proxies (not any other similar filings where disclosure may be required), and only with respect to golden parachute arrangements between the soliciting company and its NEOs, or between the soliciting company and the NEOs of the acquiring company (if the acquiring company is not the soliciting company). Thus, in the typical case where a target company solicits the merger proxy, a say-on-golden-parachute vote is not required with respect to any golden parachute arrangements between the acquiring company and the NEOs of the target company, and can be avoided by disclosing two separate tables in the merger proxy, one showing all golden parachute arrangements and the other showing only those arrangements subject to the vote.

- The say-on-golden-parachute vote is also only required with respect to golden parachute arrangements that have not previously been disclosed in the annual proxy (in accordance with the requirements described above), and subjected to the regular say-on-pay vote. Initially, it appeared that it might be a substantial benefit to companies to include enhanced disclosure of golden parachute arrangements in their annual proxies, to potentially avoid having to hold a say-on-golden-parachute later on with respect to the same arrangements. However, it now appears that the potential benefits of doing so may be minimal.

- For example, even if the golden parachute arrangements have been disclosed in the annual proxy and subjected to the say-on-pay vote, the final rules confirm that the say-on-golden-parachute vote is still required if there have been any modifications (other than a reduction in the amount of golden...
parachute compensation payable) to the arrangements since the say-on-pay vote, or if the NEOs have changed or any new arrangements (including any new equity grants pursuant to an existing arrangement) have been made or adopted. In that case, the say-on-golden-parachute vote is only required with respect to the new or modified portion of the arrangement. If a company wishes to limit the vote only to new or modified arrangements, the company must disclose two separate tables in the merger proxy, one showing all golden parachute arrangements, and the other showing only the new or modified portions of the arrangements subject to the vote.

- In addition, certain institutional shareholder groups have issued guidelines since the proposed rules came out stating that companies which disclose golden parachute arrangements in their annual proxies in accordance with the new requirements can expect to face increased emphasis on such arrangements in the groups’ assessment of what recommendation to make on the regular say-on-pay vote. Certain items (such as tax gross ups) in golden parachute arrangements may thus influence institutional shareholders to recommend a vote against the regular say-on-pay proposal, where they might otherwise have been inclined to vote in favor.

- Finally, the final rules make clear that, for golden parachute disclosure in an annual proxy to negate the need for a later say-on-golden-parachute vote, the disclosure must be presented in accordance with all of the new requirements, which are stricter than the current disclosure requirements for post-termination and change-in-control agreements under the annual proxy disclosure rules. For example, unlike the current disclosure rules for annual proxies, there is no de minimis exception for perquisites under the final rules, and no exception for health and welfare benefits provided under broad-based, nondiscriminatory plans. Having to calculate and disclose these additional amounts is an additional administrative burden that, combined with the minimal benefits from such disclosure described above, we expect will make companies less inclined to provide the enhanced golden parachute disclosure in their annual proxies.