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Final Say on Pay Rules – No Surprises, Other than from Shareholders

BY STEPHEN H. HARRIS, M'ALYSSA MECENAS & J. MARK POERIO

Introduction

On January 25, 2011, the SEC issued final rules ("Final Rules") implementing "Say on Pay," "Say on Frequency" and "Say on Parachute" requirements for companies with SEC-registered securities ("Companies"). Meanwhile, the early returns from the first spate of 2011 shareholder meetings suggest that shareholders are not merely rubber-stamping their approval, and that they want annual Say on Pay votes regardless of management proxy statement recommendations. We discuss the Final Rules below, along with insights from recent shareholder meetings.

Say On Pay Generally

Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") brought to fruition the say-on-pay effort that Representative Barney Frank (D. Mass.) championed from the mid-2000s forward. Those requirements took effect January 21, 2011 even though the SEC had not yet finalized its interpretive rules. A few days later, the SEC released its Final Rules, which generally implement Section 951 through the following requirements:

- **"Say on Pay."** No less frequently than every three calendar years, Companies must conduct a shareholder vote along with their annual or special meeting for the election of directors on a non-binding resolution to approve executive compensation, as disclosed in the Compensation Discussion and Analysis ("CD&A") and associated compensation tables (together, the "Executive Compensation Disclosure").
- **"Say on Frequency."** No less frequently than every six calendar years, Companies must conduct a shareholder vote on a non-binding resolution to determine whether to hold the Say on Pay Vote once every one, two, or three years.
- **"Say on Parachute."** When a Company sends a proxy for a shareholder meeting at which shareholders will be asked to approve an acquisition, merger, consolidation, going private transaction, or proposed sale or other disposition of all or substantially all of the Company's assets (collectively, a "Change in Control"), the associated proxy statement must:
 - disclose in plain English all named executive officer ("NEO") compensation arrangements that are contingent on the Change in Control, and
 - seek separate non-binding shareholder approval of those Change in Control arrangements that have not already been the subject of a Say on Pay vote satisfying the Say on Parachute requirements.

The Final Rules adopt most sections of the proposed rules that the SEC circulated in October 2010.¹ The principal changes made in the Final Rules:

- require that each Company disclose how frequently the Company will hold Say on Pay votes through an amended Form 8-K (rather than on a 10-K or 10-Q, as proposed), with the 8-K being due within 150 days after a Say on Frequency vote, but no more than 60 days before the deadline for submitting shareholder proposals for the next annual meeting;
 - Note that the 8-K mentioned above will amend the initial 8-K that the Company files in order to disclose the preliminary results of a Say on Frequency vote, with this initial filing being due within four business days after the end of the meeting at which the vote is held. An amendment to the initial 8-K must also disclose the final voting results, if materially different from the preliminary results, within four business days after they are known.
- increase—to a majority of votes cast—the vote threshold that permits Companies to exclude shareholder proposals relating to Say on Pay and vote frequencies;
- clarify that Say on Pay votes and Say on Frequency votes are required not less frequently than every three “calendar” years and six “calendar” years, respectively;
- provide non-exclusive “safe harbor” language for inclusion in Say on Pay resolutions;
- require inclusion of Say on Parachute votes and disclosures for preliminary proxy statements and other filings on and after April 25, 2011;²
- require, pursuant to Item 24 of Rule 14A, that proxies disclose the current frequency of Say on Pay votes and the timing of the next scheduled Say on Pay vote;
- expand Say on Parachute disclosure requirements to apply to going private transactions, tender offers, and other transactions that trigger disclosure obligations under Item 14 of Schedule 14A (note that bidders in tender offers are not required to make this disclosure);
- for smaller reporting companies (i.e., those with less than a public float of \$75 million³ as of January 21, 2011), delay the compliance deadline for the Say on Pay and Say on Frequency Rules until the Company’s first annual or other meeting that occurs on or after January 21, 2013 for the purpose of electing directors and for which executive compensation disclosure is required under Item 402 of Regulation S-K). *Note that there is no delay in the Say on Parachute disclosure or voting requirements.*

See Appendix “A” for the key differences between the proposed rules and the Final Rules.

Effective Dates

In general, the Dodd-Frank Act’s Say on Pay and Say on Frequency requirements remain effective for the first annual or special meeting of shareholders occurring on or after January 21, 2011. The particularized requirements of the Final Rules, however, do not apply until 60 days following their February 2, 2011 publication in the Federal Register, meaning the Final Rules apply to proxy statements initially filed on or after April 4, 2011.

Overview of the Final Rules

Say On Pay Resolutions

The final Say on Pay Resolution rules require Companies to disclose:

- The Say on Pay Resolution in their annual meeting proxy statements and explain its general effect, such as whether the vote is binding.
- The current frequency of Say on Pay votes and the date of the next Say on Pay Resolution.
- In their Compensation Discussion and Analysis,⁴ whether they took the results of the most recent Say on Pay vote into account in determining executive compensation policies and decisions and, if so, how that affected those compensation policies and decisions.

Companies must include specific language in the Say on Pay Resolution, stating that the purpose of the shareholder vote is “to approve the compensation of executives, as disclosed pursuant to [Item 402 of Regulation S-K] or any successor thereto.” The Final Rules provide the following non-exclusive “safe harbor” language for inclusion in Say on Pay resolutions (which likely will be adopted by most Companies without substantial modification):⁵

“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 Say on Pay Resolution is required at least once every three years. It is only required:

- For proxies solicited for annual or other meetings of security holders for which Item 402 of Regulation S-K requires executive compensation disclosure.
- For annual shareholder meetings at which proxies will be solicited for the election of directors, or special meetings held in lieu of the election meeting.

The Say on Pay Resolution rules further clarify that:

- A vote to approve a proposal unrelated to Item 402 executive compensation disclosure would not satisfy the Dodd-Frank Act Say on Pay Resolution requirements.
- Director compensation is not a required subject of a shareholder advisory vote.
- Companies subject to outstanding TARP obligations that must conduct TARP Say on Pay shareholder votes need not hold a Dodd-Frank Act Say on Pay vote, until all of their TARP obligations have been repaid.

Say on Frequency Resolutions

The adopted Say on Frequency Resolution rules require Companies to disclose:

- A brief explanation of the general effect of the Say on Frequency Resolution in the proxies, and whether it is binding.
- In their proxies, the frequency of the Say on Pay vote and the date of the next scheduled Say on Pay Resolution.
- The number of votes for each of the four vote frequency choices: one year, two years, three years, and abstention.

There is no “magic” form for the Say on Frequency Resolution, nor is there specific language that must be included in Say on Frequency Resolutions (we find it interesting that the SEC provided a safe harbor resolution for Say on Pay Resolutions, but not Say on Frequency Resolutions).

Companies must give shareholders an advisory vote at least once every six years to decide whether they wish to hold a Say on Pay vote every one, two, or three years. It is required:

- Only in proxy statements for annual or other shareholder meetings at which directors will be elected.

The Say on Frequency Resolution rules further:

- Provide that adoption of a vote frequency choice approved by a majority of votes (ignoring abstentions) will exclude shareholder attempts to deviate from that frequency by seeking “say-on-pay votes ... future say-on-pay votes, or [to change] the frequency of say-on-pay votes.”
- Create a new Form 8-K Item requiring disclosure of whether and how Companies will implement the most recent Say on Frequency Resolution results.
- Require filing of an amended Form 8-K within 150 days after a Say on Frequency vote, but no more than 60 days before the deadline for submitting shareholder proposals for the next annual meeting (this is a later deadline than the current Form 10-K or Form 10-Q requires, giving Companies more time to fully consider whether to implement the results of the frequency vote).
- Clarify that proxy cards must reflect the four shareholder choices: one year, two years, three years, and abstention.
- Limit the ability of Companies to vote uninstructed proxy cards (under Rule 14a-4 this is only permitted if the Company (1) includes a recommendation for the Say on Frequency vote in the proxy statement, (2) permits abstention on the proxy card, and (3) includes bold-face language on the proxy card regarding how uninstructed shares will be voted).

Say on Parachute Votes

The adopted Say on Parachute Vote rules require Companies to disclose, in the proxy statement for shareholder approval of a Change in Control transaction, all NEO golden parachutes in both narrative and tabular formats.

Companies must present the tabular disclosure pursuant to the following table:

Golden Parachute Compensation

Name	Cash	Equity	Pension/NQDC	Perquisites/ Benefits	Tax Reimbursement	Other	Total

- Companies must include a footnote identifying each separate form of compensation included in the reported aggregate total and must disclose in the footnotes whether each item is a “single-trigger” or “double-trigger” item.

- Companies conducting a Say on Parachute Vote must submit separate tables, with one disclosing all arrangements and one disclosing only new or revised arrangements.
- Companies must present a narrative description of all material factors relating to each golden parachute arrangement, including payment triggers, whether the payments will or could be made in a lump sum or over time, the duration of those payments, who will make the payments, any material conditions to receipt of such payments (such as satisfaction of non-compete or confidentiality conditions), the duration of such conditions, and any provisions regarding waiver or breach of such conditions.
- The tabular and narrative statements must describe compensation that is based on or otherwise relates to the Change in Control transaction.

The Say on Parachute rules further clarify that:

- Changes that only reduce the value of total compensation payable do not require a new shareholder vote, but changes that increase salary, add grants of equity compensation, or add a new NEO are subject to a new shareholder vote.
- The tabular and narrative disclosures described are not required in annual meeting proxy statements, but Companies still must include in those statements any Item 402(j) disclosures about payments made to NEOs on termination of employment.
- Golden parachute disclosures are not required for compensation that has vested previous to the pending transaction.
- Golden parachute disclosures are not required for any compensation as to which the same information has been the subject of a prior Say on Pay vote, if it remains either unchanged from the prior vote or diminished from the amount previously disclosed (note that the same information does not need to have been approved by shareholders at the prior vote, as long as the prior disclosure met the requirements under Item 402(t), described above).
- Companies do not need to hold a separate shareholder advisory vote in proxy statements for meetings that ask shareholders to approve other proposals (e.g., an increase in authorized shares or reverse stock split) that may be necessary to effectuate the transaction.
- Companies may add additional named executive officers, columns, or rows to the required tabular disclosure, as long as they are not misleading (e.g., to facilitate disclosure of which compensation arrangements are subject to single-triggers or double-triggers).

Action Items

Because the first Say on Pay and Say on Frequency votes are just now occurring, Companies should consider lessons learned from early returns disclosed in the next few weeks. Meanwhile, we generally suggest that Companies carefully consider the following (at a minimum):

Say on Pay:

- Are there any red flag issues that have the potential to prompt negative votes?

For example, there is already precedent for a negative shareholder vote that was “fueled by pay-for-performance concerns” (according to ISS, which singled-out sizable restricted stock grants in 2010 after no such awards occurred in prior years).

- How are votes materializing with your competitors and within your industry generally?
- Has the Company prefaced its CD&A with a thoughtful executive summary that justifies 2010 compensation decisions based on 2010 Company performance?

No Company wants to be the poster child for receiving an unfavorable Say on Pay vote. Note that unfavorable votes in 2010 led to management and board shake-ups for at least two Companies.

Say on Frequency:

- What steps can the Company take to improve its chances of receiving a majority vote in favor of the Company's recommendation?

Note that ISS, Fidelity, Putnam, State Street, Vanguard, and 39 other institutional investors (representing over \$830 billion in assets) have all issued policy statements favoring annual say-on-pay votes.

- How can the Company frame the proxy statement's recommended vote to best position it for a majority vote?

The ability to exclude future shareholder Say on Pay and Say on Frequency proposals makes these items worth considering.

Say on Parachutes:

- We suggest focusing less on the new Item 402(t) requirements than on updating and improving the proxy statement's Item 402(j) disclosure of termination and CIC benefits. This is because:

1. there seems little potential to ever have a Say on Pay vote sufficient to avoid a future Say on Parachute vote, and
2. there could be serious problems if a future Say on Parachute disclosure reveals material deficiencies in prior CD&A disclosures.

SEC Rules-To-Come Under the Dodd-Frank Act

The SEC has a number of rulemaking initiatives planned for the April 2011 to December 2011 period. In these next months, we anticipate that the SEC will:

- Adopt exchange listing standards for compensation committee independence and describe factors that affect compensation adviser independence under Section 952; and
- Adopt disclosure rules regarding compensation consultant conflicts under Section 952.

Last week, however, the SEC announced it will delay release of the following rule proposals until the August 2011 to December 2011 period:

- Proposed rules regarding disclosure of pay-for-performance, pay ratios, and hedging by employees and directors under Sections 953 and 955; and
- Proposed "clawback" rules regarding the recovery of executive compensation under Section 954.



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

Los Angeles

Stephen H. Harris
1.213.683.6217
stephenharris@paulhastings.com

Ethan Lipsig
1.213.683.6304
EthanLipsig@paulhastings.com

Washington, D.C.

Eric R. Keller
1.202.551.1770
erickeller@paulhastings.com

J. Mark Poerio
1.202.551.1780
markpoerio@paulhastings.com

APPENDIX A
Summary of Notable Differences
Between the Proposed Rules and the Final Rules

Proposed Rule	Adopted Rule	Difference
Required Companies to disclose how they considered the results of previous Say on Pay votes.	Requires Companies to disclose whether and how they took the results of the most recent Say on Pay vote into account in the Compensation Discussion and Analysis.	The adopted disclosure rule is narrower in scope, because it focuses on the Company's treatment of the most recent Say on Pay Resolution, rather than an indefinite number of past say on pay votes. Disclosure of prior vote consideration still is required under the general rules, if material.
Reduced burdens associated with shareholder Say on Pay proposals by allowing a Company to exclude them from its proxy if the Company implemented a vote frequency policy consistent with the plurality of votes cast for the most recent Vote Frequency Resolution.	Provides that a majority of votes (excluding abstentions) on a frequency choice, if adopted by the Company, will exclude shareholder attempts to deviate from that frequency by seeking additional (including more frequent) say on pay votes.	The proposed rule only required a <i>plurality</i> , while the adopted rule requires a <i>majority</i> of votes.
Required the Say on Pay Resolution only for proxies solicited for annual or other meetings of security holders for which Item 402 of Regulation S-K would require disclosure of executive compensation.	Adopts the proposed rule, and additionally requires the Say on Pay Resolution for annual meetings of shareholders at which proxies will be solicited for the election of directors, or special meetings held in lieu of the election meeting.	Requires Say on Pay Resolutions in additional circumstances.
Required that, <i>in addition to satisfying their Form 8-K obligations</i> , Companies disclose their decision as to how frequently they will request shareholder votes on executive compensation for the next six years on their 10-Qs covering the period in which a Say on Frequency Resolution occurred (or on their Form 10-Ks, for votes occurring during the fourth fiscal quarter covered by the 10-Ks)..	Creates a new Form 8-K Item requiring Companies to disclose whether and how they will implement the results of the most recent Say on Frequency Resolution.	Imposes a different filing requirement for disclosure of Vote Frequency Resolution implementation. Form 8-K will be due at a later date than the current Form 10-K or Form 10-Q and may give Companies more time to fully consider the results of the frequency vote.

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- ¹ For further information about the proposed rules, see our previous client alert, [The SEC Issues Proposed Rules on Dodd-Frank's Executive Compensation Shareholder Approval Rules](#).
 - ² The filings that are subject to the April 25, 2011 effective date are "initial preliminary proxy and information statements, Schedules TO, 13E-3, and 14D-9 and Forms S-4 and F-4," per the "Compliance Date" paragraph at the beginning of the Final Rules.
 - ³ For the definition of a smaller reporting company, see Rule 12b-2 under the Securities Exchange Act of 1934.
 - ⁴ The Final Rules do not require smaller reporting companies to provide a Compensation Disclosure and Analysis.
 - ⁵ Companies, however, could seek specific, separate shareholder votes on the individual aspects of executive compensation.