

# Client Alert

October 25, 2010

## SEC Proposes Rules for Implementing Say on Pay Advisory Votes

### Implementation of Some Dodd-Frank Provisions Delayed

Addressing many of the pressing questions raised by the **Dodd-Frank Wall Street Reform and Protection Act**, the SEC has proposed rules to implement Say on Pay (SOP), Say on Frequency (SOF) and Say on Golden Parachutes (SGP), collectively referred to as the SOP Advisory Votes.

In releasing its proposals on October 18, 2010<sup>1</sup>, the SEC included over 50 specific requests for comment, which are due by November 18, 2010. It is likely that final rules will be issued as soon as possible after that date. However, it is clear that SOP and SOF will be required of companies filing proxies for annual meetings on or after January 21, 2011, regardless of whether the final rules have been adopted and when the proxy materials are filed. Implementation of SGP may be delayed until final rules are adopted.

This Client Alert summarizes the key provisions of the proposed rules, as well as a companion SEC release related to Dodd-Frank's requirement that institutional investment managers disclose their SOP votes. Appendix A provides the most current schedule for implementing the Act's various compensation-related provisions; those deadlines have shifted considerably since our last Client Alert<sup>2</sup>. They include delayed implementation, presumably until the 2012 proxy season, of requirements related to clawbacks, pay-for-performance, internal equity, independence and hedging disclosure, and proxy access.

### **Say on Pay (SOP)**

Under Dodd-Frank, shareholders must be given a non-binding advisory vote on the compensation of Named Executive Officers (NEOs), as disclosed in the proxy Compensation Discussion & Analysis (CD&A) and related tables. The SEC proposed the following guidance for implementation:

- **Form of Resolution:** Rather than mandating specific language or a form for a SOP ballot, the SEC defaulted to the Dodd-Frank text and simply requires a vote on NEO disclosures required by Item 402. This would include the CD&A, compensation tables, and related narratives. However, the SEC made clear that companies may also provide advisory questions on more specific aspects of pay programs (e.g., cash compensation, golden parachute policies, severance, etc.), so long as they include the more general question regarding NEO pay as disclosed in Item 402.

<sup>1</sup>The Release can be found at: <http://sec.gov/rules/proposed/2010/33-9153.pdf>

<sup>2</sup> See <http://pearlmeier.com/Pearl/media/PearlMeyer/PDF/PMP-CA-DoddFrankBill-7-21-10.pdf?ext=.pdf>

- Explanation of Vote: The proxy must state that the company is conducting a separate SOP vote and briefly explain its general effects, including its non-binding nature.
- CD&A Enhanced Disclosure Regarding SOP votes: Starting the year after the initial SOP vote, the CD&A must explain to what extent the company's executive compensation decisions took into account the results of previous SOP outcomes.
- Items Not Covered by SOP: The SEC made clear that SOP applies only to NEO compensation required under Item 402 and does not extend to non-employee director compensation or to the impact of risk considerations on broader compensation practices.

### **Say on Frequency (SOF)**

In conjunction with the initial SOP votes, Dodd-Frank also gives shareholders a non-binding advisory vote on how often the company should hold future SOP votes. After that, a SOF advisory vote must be held at least every six years.

- Four Vote Choices: Shareholders must be given *four choices* with respect to frequency: (i) every year; (ii) every two years; (iii) every three years; or (iv) abstain. Companies may include a recommendation on frequency, but the proxy card must state that shareholders are not voting on the company's position, but on one of the four choices presented.
- Explanation of Vote: The proxy must state that the company is conducting a SOF vote and briefly explain its general effect, including its non-binding nature.
- Disclosure of the Company's Frequency Decision: The company must report its decision as to how often it will hold its SOP votes in the next Form 10-Q (or 10-K, if the vote takes place during a company's fourth quarter). It is not sufficient to simply report the non-binding SOF voting outcome in the 8-K.

***PM&P Observation***: There does not yet appear to be a clear consensus on SOF. Some institutional investors have suggested they would prefer every three years, as they are concerned about their capacity to perform an appropriate analysis of SOP for all of their investments every year. If votes were taken every three years, they would have time to thoughtfully consider the SOP vote. Of course, proxy advisory firms are in the business of outsourcing this function and are happy to help.

Others, including Institutional Shareholder Services, have suggested that an annual SOP takes the pressure off Directors. Investors have the opportunity to use SOP rather than withholding or voting against Compensation Committee chairs and members to express their dissatisfaction with a company's compensation practices.

### **Say on Golden Parachutes (SGP)**

Dodd-Frank also requires a non-binding shareholder advisory vote on golden parachute arrangements for NEOs related to the sale, consolidation or merger of their company. A separate SGP vote must be conducted at the transaction-related meeting, in addition to the shareholder vote on the transaction itself. However, a separate SGP vote is not needed for arrangements that

were already voted on by shareholders at an annual meeting under the SOP requirement. In implementing SGP, the SEC proposed the following:

- **Effectiveness:** This provision is intended to apply to M&A transaction proxies for meetings on or after 1/21/11. However, under Dodd-Frank, the SGP was not a self-executing provision, and required SEC input. Therefore, it will not in fact become effective *until the later of 1/21/11 or the date that final SEC rules are approved.*
- **Form of the Disclosure:** A table and narrative pursuant to new Item 402(t) of Regulation S-K will be required in all merger-related proxies. It applies to all golden parachute compensation among the target and acquiring corporations for the NEOs of each entity. It does not include previously vested awards or compensation related to *bona fide* post-transaction employment agreements.

This disclosure would be presented in both tabular and narrative form, as follows:

**Golden Parachute Compensation**

Name	Cash(\$)	Equity(\$)	Pension/NQDC(\$)	Perquisites/ Benefits(\$)	Tax Reimbursement(\$)	Other(\$)	Total (\$)
PEO							
PFO							
A							
B							
C							

For purposes of this table:

**Cash:** Includes any cash payment (e.g., base salary, bonus, pro-rata non-equity incentive plan compensation).

**Equity:** Includes the dollar value of accelerated stock awards, in-the-money option awards for which vesting will be accelerated, and payments in lieu of cancelled stock and option awards. Vested amounts are not included. Payouts based on stock price are valued as of the last practicable date (in the event of a merger proxy) or the last business day of the last completed year (for the annual proxy).

**PM&P Observation:** There is sentiment among some observers that full “take-out” value should be provided in the current termination disclosures under Item 402(j), including the executive’s vested equity, so investors understand the full extent of termination benefits. While current SEC rules under Item 402(j) are silent on the matter, the proposed rules seem to confirm the SEC’s intent to include only unvested values in displaying termination benefits.

**Pension/NQDC:** Includes pension and non-qualified deferred compensation enhancements.

**Perks:** The value of *all* executive perquisites and benefits, including generally available benefits or *de minimis* benefits.

**Tax reimbursements:** An example would be Internal Revenue Code Section 280G tax gross-ups.

**Other:** A catch-all for any other elements of compensation not otherwise included.

**PM&P Observation:** This table differs significantly from existing termination disclosure in Item 402(j). The current disclosure: (i) does not require tabular disclosure or a total number; (ii) allows companies to exclude *de minimis* perquisites (i.e., those under \$10,000) and the value attributable to arrangements that do not discriminate in scope, terms or operation in favor of executive officers; and (iii) covers all termination events, not just those that are transaction-related. Note that if a company decides to provide the additional golden parachute narrative and table in its annual proxy statement, it must still include the current termination disclosures required under Item 402(j).

A footnote must be provided for each column of the table indicating whether the payment is “single trigger” (payable upon the transaction) or “double trigger” (payment upon certain terminations within a specified time following the transaction).

The narrative disclosure must describe the specific circumstances that would trigger the payment; whether it would be in lump-sum or annual installments (and the duration of installments); and who would make the payment. It must also state any material conditions or obligations applicable to the payment (e.g., non-compete, non-solicitation, non-disparagement and confidentiality agreements), their duration, and any waiver and breach conditions.

- Exception Where SGP Vote Covered by Annual SOP Vote. If the above narrative and tables are provided in an annual meeting proxy statement that includes a SOP vote, any subsequent M&A transaction proxies can exclude the SGP vote **as long as no changes or modifications** were made to the golden parachute arrangements as disclosed in the annual SOP vote. If changes were made, the company must provide a separate table with the modifications and the separate SGP vote can be limited to those changes only. Also note that regardless of whether a SGP vote is required in an M&A transaction proxy, complete golden parachute disclosure must be provided.

**PM&P Observation:** One of the most important decisions facing companies will be whether to include the new golden parachute disclosure in their upcoming SOP vote to avoid the necessity of obtaining a separate SGP vote in the context of a future M&A transaction. While tempting, companies should keep in mind that if the pay arrangements are modified in the interim, or new agreements are adopted, they will be subject to a separate SGP vote at the time of the transaction. This exception also does not apply to new equity awards that were not subject to the previous SOP vote. Finally, companies should weigh whether “bundling” SGP with the general SOP resolution might jeopardize the SOP outcome, since shareholders who are dissatisfied only with the SGP might vote against the entire SOP resolution.

Since it is likely some change or modification will take place between when the proxy is filed and when a transaction is submitted for shareholder approval, we expect many companies will NOT include the SGP in their annual SOP.

### General Proposed Guidance

- Preliminary Proxy Statements Not Required: The SEC confirmed that including a SOP or SOF in the proxy statement would not trigger the filing of a preliminary proxy statement. This was an open issue in the Dodd-Frank legislation.
- No Exemption for Smaller Issuers: Dodd-Frank instructed the SEC to consider whether to exclude smaller issuers (historically defined by the SEC as those with a public float of under \$75 million) from the SOP Advisory Vote requirements. The proposed rules do not provide such an exemption. However, they make clear that smaller reporting companies will not have to prepare a CD&A – instead, investors would base their votes on the disclosures currently required of smaller issuers (i.e., compensation paid to top three executives, as disclosed in the required tables and abbreviated accompanying narratives).
- No Broker Discretionary Voting: The proposed rules confirm that uninstructed broker votes are not permitted for SOP and SOF votes.
- Exemption for TARP Companies: Companies that received assistance under the Troubled Asset Relief Program (TARP) already are required to hold SOP votes. They are exempt from these SOP and SOF requirements until they repay their indebtedness and are no longer subject to the TARP rules.
- Preemption of Future Shareholder Proposals: If a company adopts the most recent SOF alternative approved by a **plurality** of shareholders, it can exclude any subsequent shareholder proposals related to SOP or SOF from the proxy.

**PM&P Observation:** Clearly, the rules create an incentive for companies to follow the plurality view on SOF to avoid additional shareholder proposals on pay issues until the next required SOF vote six years later.

### Institutional Investment Manager Vote Disclosures

Under Dodd-Frank, institutional investment managers that manage accounts with an aggregate fair market value of at least \$100 million must report at least annually how they voted on SOP Advisories. In brief, the proposed rules<sup>3</sup> provide that the information that is required to be disclosed on Form N-PX will now include:

- Name of the issuer of the security
- The exchange ticker symbol of the security and its CUSIP number
- Shareholder meeting date
- A brief identification of the matter voted on
- Whether the matter was proposed by the issuer or a shareholder
- Number of shares the reporting person was entitled to vote or had or shared voting power over
- The number of shares actually voted
- How the person voted those shares
- Whether the vote was for or against management's recommendation
- Identification of each institutional investment manager on whose behalf the Form N-PX was filed

---

<sup>3</sup> The release can be found at: <http://sec.gov/rules/proposed/2010/34-63123.pdf>

### **Conclusion**

The SEC proposed rules answered many of the pressing questions raised by Dodd-Frank on the SOP Advisory Vote issues, including the four-choice ballot format of the SOP vote as well as details about what should be included in the new SGP disclosure. However, as the SEC provided no further guidance with respect to the SOP resolution's language or form, companies still will need to determine the best strategy for framing their own compensation-related SOP resolution. Time will tell, but we expect many companies will resort to boilerplate that mimics the Dodd-Frank text, similar to the approach that was taken last year by many TARP companies in meeting their SOP requirements.

## APPENDIX A

### Updated Timeline of Implementation for Dodd-Frank Act Compensation and Governance Provisions

Provision	Effective Dates	Further Action Scheduled
Broker Non-Vote on Executive Compensation	As of 07/21/2010 (subject to SEC transition rules)	SEC to issue proposed rules Q2, 2011
Say-On-Pay and Say-On-Frequency	Proxy statements for meetings on or after 01/21/2011	SEC issued proposed rules October 18, 2010 SEC to issue final rules Q1, 2011
Say-On-Golden Parachute	The later of the date that final rules are issued or 01/21/2011	SEC issued proposed rules October 18, 2010 SEC to issue final rules Q1, 2011
Financial Institution Excessive Compensation Rules	Rules to be issued by 04/21/2011	SEC to issue proposed rules Nov-Dec, 2010 SEC to issue final rules Q2, 2011
Compensation Committee & Advisor Independence; Committee's Oversight Authority	Effective by 07/16/2011, so presumably by end of Q2, 2011	SEC to issue proposed rules Nov-Dec, 2010 SEC to issue final rules Q2, 2011
Disclosure of Compensation Consultant Conflict of Interest	Proxy statements for meetings occurring on or after 07/21/2011	SEC to issue proposed rules Nov-Dec, 2010 SEC to issue final rules Q2, 2011
Clawback Policy	Presumably 2012 proxy statements	SEC to issue proposed rules Q2, 2011
Pay-for-Performance Disclosure	Presumably 2012 proxy statements	SEC to issue proposed rules Q2, 2011
Internal Equity Ratio Disclosure	Presumably 2012 proxy statements	SEC to issue proposed rules Q2, 2011
Disclosure of Hedging	Presumably 2012 proxy statements	SEC to issue proposed rules Q2, 2011
Disclosure of COB/CEO Roles	The SEC's rules should address the effective date, but it is so similar to 2010 rule that it should probably be addressed in 2011 proxy	SEC required to issue rules by 01/17/2011 (but SEC has not committed to date in recent publication)
Proxy Access	SEC issued final proxy rules August 25, 2010; effective 60- days from publication in Federal Register, but delayed implementation pending Court of Appeals review	Court of Appeals review – expedited, but no firm dates set

**Important Notice:** Pearl Meyer & Partners has provided this analysis based solely on its knowledge and experience as compensation consultants. In providing this guidance, Pearl Meyer & Partners is not acting as your lawyer and makes no representations or warranties respecting the legal, tax or accounting implications or effectiveness of this advice. You should consult with your legal counsel and tax advisor to determine the effectiveness and/or potential legal impact of this advice. In addition, this Client Alert is not intended or written to be used, and cannot be used by you or any other person, for the purpose of (1) avoiding any penalties that may be imposed by the Internal Revenue Code, or (2) promoting, marketing or recommending to another party any transaction or other matter addressed herein, and the taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

#### **About Pearl Meyer & Partners**

*For over 20 years, PM&P has served as a trusted independent advisor to Boards and their senior management in the areas of compensation governance, strategy and program design. The firm provides comprehensive solutions to complex compensation challenges through the development of programs that align rewards with business goals to create long-term value for all stakeholders: shareholders, executives and employees. The firm maintains offices in New York, Atlanta, Boston, Charlotte, Chicago, Houston, Los Angeles and San Jose.*

**NEW YORK**

570 Lexington Avenue  
New York, NY 10022  
(212) 644-2300  
newyork@pearlmeyer.com

**ATLANTA**

One Alliance Center  
3500 Lenox Road, Suite 1708  
Atlanta, GA 30326  
(770) 261-4080  
atlanta@pearlmeyer.com

**BOSTON**

132 Turnpike Road, Suite 300  
Southborough, MA 01772  
(508) 460-9600  
boston@pearlmeyer.com

**CHARLOTTE**

3326 Siskey Parkway, Suite 330  
Matthews, NC 28105  
(704) 844-6626  
charlotte@pearlmeyer.com

**CHICAGO**

123 N. Wacker Drive, Suite 1225  
Chicago, IL 60606  
(312) 242-3050  
chicago@pearlmeyer.com

**HOUSTON**

Three Riverway, Suite 1575  
Houston, TX 77056  
(713) 568-2200  
houston@pearlmeyer.com

**LOS ANGELES**

550 S. Hope Street, Suite 1600  
Los Angeles, CA 90071  
(213) 438-6500  
losangeles@pearlmeyer.com

**SAN JOSE**

2880 Zanker Road, Suite 203  
San Jose, CA 95134  
(408) 954-7399  
sanjose@pearlmeyer.com



[www.pearlmeyer.com](http://www.pearlmeyer.com)