

# SEC proposes new rules to implement 'say on pay' for executives

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"Say on pay" has been a hot-button issue for institutional investors and corporate governance activists for several years now. The recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 addressed this issue by including in new Section 14A of the Securities Exchange Act of 1934 a requirement for shareholder advisory "say on pay" votes on public company executive compensation, including so-called golden parachutes payable in connection with corporate change-in-control transactions.<sup>1</sup>

The Securities and Exchange Commission has proposed amendments to the federal proxy rules designed to implement "say on pay" voting as mandated by the Wall Street Reform Act.<sup>2</sup> The agency echoes the principles enumerated in the law that these shareholder votes are advisory only and shall

proxy statements relating to an issuer's first annual meeting occurring on or after Jan. 21, 2011. On the other hand, a vote on golden parachutes will not be required until final rules adopted by the SEC become effective.

## 'SAY ON PAY'

Proposed Exchange Act Rule 14a-21(a) would require SEC-registered issuers, *at least once every three years*, to provide shareholders with a separate advisory vote to approve the compensation of its "named executive officers" as disclosed in the issuer's annual meeting proxy statement. This vote would be required only in connection with annual meetings or other shareholder meetings for which SEC rules require proxy statement disclosure of executive compensation. Notably, the executive compensation to be

submitted to shareholders, the SEC indicates that the say-on-pay vote "must relate to all executive compensation disclosure set forth [in the applicable proxy statement] pursuant to Item 402 of Regulation S-K." This means, for instance, that a vote that by its terms is "to approve only compensation policies and procedures" would not be compliant.

Finally, the proposed rules would amend Item 402(b) of Regulation S-K to require CD&A disclosure of "whether and, if so, how" the issuer's executive compensation policies and decisions have taken into account the results of say-on-pay votes. As a result, although the votes are supposed to be only advisory in nature, issuers will be required to disclose whether they have taken the results of such votes into consideration in designing executive compensation.

## 'SAY ON FREQUENCY'

Proposed Exchange Act Rule 14a-21(b) would require SEC-registered issuers to provide shareholders with a separate advisory vote, *at least once every six years*, on whether the say-on-pay vote will occur every one, two or three years. Like the say-on-pay vote itself, this "say on frequency" vote would be required only in connection with annual meetings or other shareholder meetings for which SEC rules require proxy statement executive compensation disclosure. Proposed Item 24 to Schedule 14A also would require issuers to "briefly explain the general effect of each [say-on-frequency] vote," including its non-binding nature.

To facilitate "say on frequency" voting, the proposed rules would amend Exchange Act Rule 14a-4 to require that the proxy card provided to shareholders include four choices regarding the say-on-frequency vote: every one year, every two years, every three years or abstain.

The SEC presumes that the issuer's "board of directors will include a recommendation as to how shareholders should vote on the frequency of shareholder votes on executive compensation," but also notes that "the issuer must make clear in these

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not be construed "as overruling a decision" by an issuer or its board of directors, nor do the votes "create or imply any change to the fiduciary duties of," or "create or imply any additional fiduciary duties for," an issuer or its board of directors.

Despite the advisory nature of these votes, corporate boards that ignore their results will certainly attract the attention, if not incur the wrath, of institutional investors and proxy advisory firms, which could affect future director elections.

The SEC's release announcing the proposal contains numerous requests for comments, so it would not be surprising to see revisions to the proposed rules before they become effective. The public comment period for the proposed rules expired Nov. 18. It should be noted, however, that regardless of whether the proposed rules have been finalized, the Wall Street Reform Act requires a "say on pay" resolution to be included in

voted on would include the compensation summarized in the CD&A (compensation discussion and analysis), the compensation tables, and other required narrative compensation disclosures.

In contrast, an issuer's disclosure regarding its "compensation policies and practices as they relate to risk management and risk-taking incentives" would not be subject to the shareholder advisory vote because such policies and practices "relate to the issuer's compensation for employees generally." The SEC notes, however, that if risk considerations "are a material aspect" of compensation policies or decisions for an issuer's named executive officers, the issuer must discuss such policies or decisions as part of its CD&A. In that case, such disclosure would be considered by shareholders in the "say on pay" vote.

Although the proposed rules do not specify the form of the say-on-pay resolution to be

circumstances that the proxy card provides for four choices ... and that shareholders are not voting to approve or disapprove the issuer's recommendation."

### 'SAY ON GOLDEN PARACHUTES'

Proposed Exchange Act Rule 14a-21(c) would require SEC-registered issuers, in connection with any solicitation undertaken by the issuer in connection with a shareholders meeting, to approve "an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all the assets" (called an "M&A transaction"), to provide shareholders with a separate advisory vote to approve golden-parachute compensation arrangements for its named executive officers (other than any such arrangements with the acquiring company). The golden-parachute arrangements to be approved would be those disclosed pursuant to proposed Item 402(t) of Regulation S-K described below.

The proposed rule allows an issuer to dispense with such a vote if the issuer had previously included the requisite golden-parachute compensation disclosure, on a voluntary basis, in an annual meeting proxy statement that included a say-on-pay vote. To satisfy this exception, the issuer's annual meeting proxy statement would need to include the new disclosure required by Item 402(t). However, any subsequently adopted golden-parachute arrangements or revisions to the previously-described golden-parachute terms would be subject to a vote at the shareholders meeting for the M&A transaction.

As noted above, the new golden-parachute disclosure requirements would be set forth in proposed Item 402(t) of Regulation S-K. This disclosure would be required in any proxy statement relating to an M&A transaction, but generally will not be required in annual meeting proxy statements. It should be noted that the current proxy rules already require a certain amount of disclosure of change-in-control compensation arrangements for company executives in annual meeting proxy statements.

Proposed Item 402(t) of Regulation S-K would require disclosure of golden-parachute arrangements "with respect to each named executive officer of the acquiring company and the target company" in both tabular and narrative formats (see box for details).

If the only golden-parachute arrangements that are subject to a vote at a shareholders meeting called to approve an M&A transaction are those entered into since a previous say-on-pay vote, the issuer's proxy statement for such meeting must contain two tables: one disclosing all golden-parachute compensation and another disclosing only the new arrangements.

Because change-of-control transactions can be structured in ways that do not require a shareholder vote solicited via a Schedule 14A proxy statement, the proposed rules

also would require golden-parachute disclosure in:

- Information statements under Regulation 14C relating to meetings or actions by written consent for which proxies or consents are not being solicited.
- Proxy or consent solicitations unrelated to merger proposals but requiring disclosure of an M&A transaction under Item 14 of Schedule 14A.
- Form S-4 registration statements containing disclosure relating to an M&A transaction.

### Tabular format

- Quantitative disclosure of the individual elements of the compensation that each named executive officer would receive based on or otherwise relating to an M&A transaction, as well as the total for each named executive officer.
- The individual elements of compensation to be disclosed would include
  - Cash severance payments.
  - Dollar value of accelerated stock awards, dollar value of stock awards whose vesting would be accelerated and payments in cancellation of stock and option awards.
  - Pension and nonqualified deferred compensation benefit enhancements.
  - Perquisites and other personal benefits and health and welfare benefits.
  - Tax reimbursements.
  - Any other "additional elements of compensation not specifically includable in the other columns of the table."
- Footnote identification of payments triggered by the M&A transaction itself ("single-trigger") versus those triggered by additional events such as termination of employment ("double-trigger").
- Quantification of any agreements or understandings, written or unwritten, between each named executive officer and the acquiring or target company "concerning any type of compensation, whether present, deferred or contingent," relating to the M&A transaction in question. Disclosure would not be required of compensation already disclosed in the proxy statement pension or deferred compensation table, previously vested equity awards, or compensation under "bona fide post-transaction employment agreements."

### Narrative format

Description of any material conditions or obligations to receipt of golden-parachute payments, including non-compete, non-solicitation, non-disparagement or confidentiality agreements, together with their duration and provisions regarding waiver or breach.

Description of the specific circumstances triggering payment, by whom such payments would be made, whether such payments are lump sum or annual, and their duration, and any other material factors regarding each agreement.

- Schedule 13E-3 going-private-transaction statements.
- Schedule TO and Schedule 14D-9 relating to third-party tender offers.

## RELATED MATTERS

In connection with the proposed rules, the SEC's release addresses several related matters.

The proposed rules do not mandate any specific language for the "say on pay" or "say on golden parachute" resolution to be put to a shareholder vote. That is left to each issuer. But, as noted above, the say-on-pay vote must by its terms relate to all executive compensation and not just a subset thereof.

Because the new votes are only advisory in nature, the proposed rules specify neither which shares are entitled to participate in any of the votes mandated by proposed Exchange Act Rule 14a-21, nor the percentage vote required to approve each matter. That also will be left to each issuer to deal with in connection with its compensation policy for named executive officers.

The SEC proposes to amend Exchange Act Rule 14a-8 to clarify when an issuer may rely on the rule's "substantially implemented" exclusion to exclude from future proxy statements shareholder proposals relating to shareholder votes on executive compensation. Specifically, this proposed amendment would provide that if an issuer implements the frequency for say-on-pay voting receiving the plurality of the votes cast at the most recent meeting at which "say on frequency" has been put to a vote, the issuer may exclude from future proxy statements any shareholder proposal "that would provide a say-or-pay vote or seeks future say-or-pay votes or that relates to the frequency of say-or-pay votes."

The proposed rules also would require disclosure in the next Form 10-Q (or in the case of the fourth quarter, the next Form 10-K) of an issuer's decision regarding how often it actually will seek a say-on-pay vote "in light of the results of the shareholder vote on frequency." In one of its requests for comment, the SEC asks whether this disclosure should instead be required in the Form 8-K announcing the result of the vote, which must be filed within four business days following the applicable shareholders meeting.

The proposed rules would amend Exchange Act Rule 14a-6(a) to provide that inclusion of a say-on-pay or say-on-frequency vote in a proxy statement would not trigger the need for a preliminary filing of the issuer's proxy statement. On the other hand, because a "say on golden parachute" vote would be included in a proxy statement relating to an M&A transaction, Exchange Act Rule 14a-6(a) would require the filing of a preliminary proxy statement in that case.

Finally, the SEC release confirms that, in accordance with the Wall Street Reform Act, the rules of the national securities exchanges are being revised to prohibit broker discretionary voting on any vote required under proposed Exchange Act Rule 14a-21.

## TRANSITIONAL MATTERS

In the release, the SEC notes that the Wall Street Reform Act requires that separate say-on-pay and say-on-frequency votes be considered at any annual meeting to be held on or after Jan. 21, 2011, regardless of whether the SEC has adopted rules relating to such votes.

Accordingly, any proxy statement filed in connection with an annual meeting to be held on or after Jan. 21, 2011, whenever filed and whether in preliminary or definitive form, must include say-on-pay and say-on-frequency votes.

Accordingly, as a transitional matter, the SEC said it will not object if any issuer that files

such a proxy statement before the proposed rules are finalized and become effective:

- Does not file preliminary proxy materials even though shareholders are being asked to vote on "say on pay" and "say on frequency," which technically would trigger such a filing under current Exchange Act Rule 14a-6(a).
- In the event that proxy service providers are not able to reprogram their systems to enable shareholders to vote on four choices, includes on its proxy card only *three choices* relating to the say-on-frequency vote (every one, two or three years) and not the ability to abstain. In such instance, the proxy will not be voted on the say-on-frequency matter if none of the three choices is selected.

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## NOTES

<sup>1</sup> For a further discussion of the Wall Street Reform Act, see Robert Reder, *Corporate Governance Highlights of the Dodd-Frank Act*, WESTLAW JOURNAL CORPORATE OFFICERS & DIRECTORS LIABILITY (Aug. 2, 2010), Milbank, Tweed, Hadley & McCloy Client Alert, "Accredited Investor" Standard for Reg D Offerings Tightened by Wall Street Reform Act (Aug. 4, 2010), available at [http://www.milbank.com/NR/rdonlyres/7FAC657C-7303-4B54-BA71-02709A3FF7E2/0/080410\\_Accredited\\_Investor\\_Standard\\_Tightened.pdf](http://www.milbank.com/NR/rdonlyres/7FAC657C-7303-4B54-BA71-02709A3FF7E2/0/080410_Accredited_Investor_Standard_Tightened.pdf).

<sup>2</sup> See SEC, Shareholder Approval of Executive Compensation and Golden Parachute Compensation, Release No. 33-9153 (Oct. 18, 2010), available at <http://sec.gov/rules/proposed/2010/33-9153.pdf>.



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