LEGAL UPDATES

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SEC Proposes Dodd-Frank Say-on-Pay Rules

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Professional

KIRSTIN P. SALZMAN
KANSAS CITY:
816.983.8316
KIRSTIN.SALZMAN@
HUSCHBLACKWELL.COM

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) requires companies subject to SEC-reporting rules to obtain a non-binding shareholder vote on (1) executive compensation (say-on-pay), at least once every three years; (2) the frequency of the say-on-pay vote (frequency), once every six years; and (3) executive compensation tied to merger and acquisition transactions (say-on-golden parachute). On October 18, 2010, the Securities and Exchange Commission (SEC) announced proposed rules to implement these requirements—the so-called say-on-pay rules.

While the rules are only proposals, there are affirmative steps that companies should take to prepare for the upcoming proxy season. Most importantly, Dodd-Frank provides that the say-on-pay and frequency vote requirements apply to all annual meetings held on or after January 21, 2011 regardless of when the proxy statement was filed or whether the SEC rules have been adopted. The golden parachute approval requirement, however, will not go into effect until after the final rules are adopted by SEC.

SAY-ON-PAY

Shareholder Voting. The proposed rule states that shareholders must be offered a non-binding, advisory vote at least once every three years to approve the compensation of a company's named executive officers. The vote must encompass the information required to be disclosed under Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, the compensation tables, and other narrative descriptions of executive compensation disclosures.

Disclosure. The proposed rules intentionally omit any specific language that a company must use in its say-on-pay proposals. The SEC states only that the vote must cover compensation disclosed in the proxy and that general language that only allows shareholders to approve "compensation policies and procedures" is insufficient. The proxy statement should also state that the vote is simply advisory and non-binding. After the vote, the company's Compensation Discussion & Analysis section must address whether and to what extent previous say-on-pay votes were considered by the company.

Additional Items of Interest. A proposed amendment to Rule 14a-6 clarifies that companies will not be required to file a preliminary proxy statement with the SEC solely because of the say-on-pay vote or the frequency vote. Additionally, Dodd-Frank indicates that say-on-pay and frequency votes will not be considered "routine" matters, meaning that brokers will not be able to cast discretionary votes for uninstructed shares. Finally, companies that received financial assistance through TARP must conduct a separate shareholder vote to approve executive compensation until all outstanding TARP debts are repaid. Dodd-Frank does not impose any requirement that these companies conduct an additional advisory vote.

FREQUENCY VOTE

Shareholder Voting. The proposed rules contemplate that shareholders will have four choices concerning the frequency of the say-on-pay vote: holding a vote every year, every other year, once every three years, or abstaining from voting on the matter. The company's board of directors may (but are not required to) recommend a frequency, but the proxy card must clarify that the shareholder is voting on one of the choices listed on the card and not on the board's recommendation..

Disclosure. Following the vote, a company must disclose its decision as to how frequently the say-on-pay vote will occur. Notice must appear in the company's next Form 10-K or Form 10-Q, depending on which quarter the frequency vote is cast by the shareholders.

Incentives. While the outcome of the vote is only advisory, the proposed rules create incentives for a company to follow its shareholders' advice. If the shareholders' preference is followed, the company can exclude shareholder proposals under Rule 14a-8 that request additional or different say-on-pay votes or frequency votes from its proxy statement.

SAY-ON-GOLDEN-PARACHUTES

The SEC's proposal regarding golden parachutes involves two components: expanded disclosure requirements and a shareholder advisory vote.

Expanded Disclosure of Golden Parachute Arrangements

General. The SEC proposed new Item 402(t) of Regulation S-K, which provides that the proxy or solicitation materials for a meeting in which shareholders will be asked to approve certain merger and acquisition transactions of a public company must also disclose all golden parachute compensation arrangements of the named executive officers of both the target company and the acquiring company. In addition, the SEC proposed that these new disclosures be made not only in proxy or solicitation materials, but also in certain filings related to mergers and similar transactions, including certain registration statements, information statements, going private transactions and tender offers.

Golden Parachute Defined. The SEC's definition of a golden parachute tracks the broad language contained in Dodd-Frank and includes "any agreements or understandings, whether written or unwritten, between each named executive officer and the acquiring company or the target company, concerning any type of compensation, whether present, deferred or contingent, that is based on or otherwise relates to an acquisition, merger, consolidation, sale or other disposition of all or substantially all assets." The definition does not include compensation that is based on or related to the transaction, such as compensation disclosed in a company's Pension Benefits table and Nonqualified Deferred Compensation table, previously vested equity awards, and compensation from bona fide post-transaction employment agreements.

Disclosure Requirements. Disclosure of golden parachute compensation is generally required under the existing rules, but the new rules would impose more extensive requirements concerning the scope and substance of the disclosures. For instance, the proposed disclosures must be provided in both tabular and narrative formats and must include certain prescribed elements.

Tabular Disclosure. Companies must separately quantify and provide a total aggregate dollar value of the following compensation elements received by a named executive officer in a table format: (1) cash severance payments (e.g., base salary, bonus and pro-rated non-equity incentive compensation plan payments); (2) the dollar value of stock awards and in-the-money option awards for which vesting would be accelerated, and payments in cancellation of stock and option awards; (3) pension and non-qualified deferred compensation benefit enhancements; (4) perquisites and other personal benefits or health and welfare benefits; (5) tax reimbursements (e.g., tax gross-ups); and (6) any other elements of compensation. Further, companies are required to footnote amounts that are triggered by a merger or acquisition transaction ("single trigger" payments) and which amounts are contingent upon additional conditions, such as termination of employment ("double trigger" payments).

Narrative Disclosure. In the narrative disclosure, companies are required to describe material conditions or obligations applicable to the payments or benefits, the circumstances that would trigger such payments, whether the payments are lump sum or annual, and the duration of such payments, as well as by whom the payments will be made.

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Shareholder Approval of Golden Parachute Arrangements

Required Vote. The SEC's proposed rules also require public companies to hold a separate, non-binding shareholder vote to approve any golden parachute arrangements between the company soliciting the vote and executives of the target or acquiring company.

Exceptions. The proposed rules do not require that a target company hold a separate shareholder vote on golden parachute arrangements between the acquiring company and the target company's executives (though such arrangements must be disclosed pursuant to new Item 402(t)). Say-on-golden parachute votes are also not required if the golden parachute arrangements were included in a regular say-on-pay vote, as long as no new arrangements or changes to the existing arrangement have occurred since the vote. New golden parachute arrangements or revisions to existing arrangements must be subject to a separate shareholder vote.

What This Means To You

Because the say-on-pay and frequency vote rules are self-effectuating as of January 21, 2011, all public companies, including smaller reporting companies, should prepare to include these provisions in their 2011 proxy statements. Companies should also consider whether to include the terms of any existing golden parachutes as part of the regular say-on-pay vote, and boards of directors should consider whether to make a recommendation with respect to a frequency vote.

Contact Info

If you would like to discuss these issues or any other Securities & Corporate Governance legal matters, please contact your Husch Blackwell attorney.

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