

# FREDERIC W. COOK & CO., INC.

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October 21, 2010

## **SEC Proposed Rules on Shareholder Advisory Votes on Say on Pay, Frequency of Say on Pay Votes, and Golden Parachute Compensation**

*Say on Pay Votes and Frequency of Say on Pay Votes  
Required at Annual Meetings Occurring on or after January 21, 2011*

### **Executive Summary**

On October 18, 2010, the Securities and Exchange Commission (SEC) issued proposed rules to implement the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Act) relating to the advisory shareholder votes required on (1) executive compensation (i.e., the Say on Pay Vote), (2) the frequency of Say on Pay votes (i.e., the Say on Frequency Vote), and (3) golden parachute compensation based on or relating to the acquisition, merger, consolidation, sale or other disposition of the assets of a public company (i.e., the Say on Parachute Vote). In view of the relatively short time-frame for the required votes for the first Say on Pay and Say on Frequency Votes (annual meetings on or after January 21, 2011), public companies should promptly begin consideration of revisions to their proxy statement executive compensation disclosure in connection with the votes. The key provisions in the SEC's proposed rules are:

- No specific language is required for the resolutions on the Say on Pay, Say on Frequency or Say on Parachute Votes.
- Shareholders must be given four choices on the Say on Frequency Vote: every year, every two years, every three years, or abstention from voting.
- Disclosure of the company's decision on how frequently it will hold Say on Pay Votes in light of the Say on Frequency Vote is required in the Form 10-Q filed following the frequency vote (or Form 10-K if the vote occurs in the company's fourth quarter).
- The disclosure of golden parachute compensation for the Say on Parachute Vote must be in both tabular and narrative form.
- There is an exception from the Say on Parachute Vote if compensation has been subject to a prior Say on Pay Vote. This exception will only apply to the extent that the golden parachute compensation arrangements have not been modified and do not apply to new arrangements since the prior vote. New equity compensation awards would not be covered by the exception.

- Companies that are required to hold an annual say on pay vote because they have received financial assistance under the Troubled Asset Relief Program (TARP) are not required to comply with the new Say on Pay and Say on Frequency Vote rules until they have repaid all of their TARP indebtedness and are no longer subject to the annual say on pay vote required under TARP.

The proposed rules are very clear that all three votes are advisory only and a company is free to disregard them. Companies should, however, carefully consider the potential consequences of not following the shareholder vote on a Say on Frequency Vote (including the effect on excluding shareholder proposals discussed below) or not responding to a Say on Pay Vote before taking such actions.

### **Say on Pay Vote**

The Say on Pay Vote is only required when proxies are solicited for an annual or other shareholder meeting for which the disclosure of executive compensation is required under Item 402 of Regulation S-K. A company required to hold an annual say on pay vote because it has received TARP financial assistance is not required to hold a Say on Pay Vote under the new rules until all of its TARP indebtedness has been repaid.

The Say on Pay Vote applies to the compensation of named executive officers as disclosed pursuant to Item 402; i.e., the Compensation Discussion and Analysis (CD&A), the compensation tables, and related narrative disclosure. The vote does not apply to non-employee director compensation or any discussion of how compensation policies and practices relate to risk management and risk-taking incentives; the SEC has noted that if risk considerations are a material aspect of compensation policies or decisions for named executive officers, they must be discussed in the CD&A and thus would be considered by shareholders as part of their decision on the Say on Pay Vote.

The first Say on Pay Vote is required for annual meetings occurring on or after January 21, 2011, regardless of when the rules are finalized. The proposed rules do not prescribe the wording or form of the Say on Pay resolution to be voted on by shareholders. The proxy statement must, however, state that the company is providing a separate shareholder vote on executive compensation and explain the effect of the vote, including its non-binding nature.

In addition, the CD&A must discuss whether the company's compensation policies and decisions have taken the results of the Say on Pay Vote into consideration and, if so, how consideration of the vote affected the compensation policies and decisions. This requirement would not be applicable until after a company has held its first Say on Pay Vote.

Note that the result of the Say on Pay Vote must be disclosed on a Form 8-K within four business days after the meeting at which the vote is held.

## **Say on Frequency Vote**

The Act requires that shareholders be provided with a separate non-binding vote, at least every six years, on whether the Say on Pay Vote should occur annually, every two years, or every three years. A company required to hold an annual say on pay vote because it has received TARP financial assistance is not required to hold a Say on Frequency Vote until all of its TARP indebtedness has been repaid.

Under the proposed rules shareholders must be provided with four choices under the Say on Frequency Vote: whether the Say on Pay Vote will be every year, every two years, every three years, or to abstain from voting. If proxy service providers will not be able to reprogram their systems to permit shareholders to vote among four choices, until the SEC finalizes the rules the SEC will not object if shareholders are only offered the choice of holding the vote every year, every two years, or every three years. In that event, if no choice is selected by the shareholder, the proxy will not be voted.

The SEC expects that the board of directors will include a recommendation on the Say on Frequency Vote. If it does, the company must make it clear that the proxy card provides the four choices described above and that shareholders are not voting on the approval or disapproval of the recommendation.

In addition to disclosing the result of the Say on Frequency Vote on a Form 8-K, the company must disclose in the next Form 10-Q following the vote (or Form 10-K if the vote occurs in the company's fourth quarter) its decision on how frequently it will conduct Say on Frequency Votes in light of the advisory vote by shareholders. Depending on the timing of a company's annual meeting, it may be necessary for the Board to meet relatively quickly after the Say on Frequency Vote to determine what position it will take regarding the frequency of the Say on Pay Vote.

## **Exclusion of Shareholder Proposals Relating to Say on Pay and Say on Frequency Votes**

The proposed rules provide that a company may exclude from its proxy a shareholder proposal relating to a say on pay vote, future say on pay votes, or the frequency of say on pay votes if the company has adopted a policy on the frequency of Say on Pay Votes that is consistent with the plurality of the votes cast by its shareholders in the most recent Say on Frequency Vote.

## **Disclosure of Golden Parachute Compensation**

In any proxy or consent solicitation relating to a meeting at which shareholders are asked to approve an acquisition, merger, consolidation or sale of all (or substantially all) of a company's assets (i.e., a "change in control transaction"), the Act requires that the person making the solicitation (typically the target company) must disclose all agreements or understandings that the person has with named executive officers of the company for any golden parachute compensation relating to the change in control transaction that will or may be payable. The proposed rules also require disclosure of agreements or understandings for golden parachute compensation between the acquiring company and the named executive officers of the target

company. These disclosure requirements do not apply until the SEC rules are effective, which is expected to be on or close to the January 21, 2011 effective date for the Say on Pay and Say on Frequency Votes.

Under the proposed rules, the elements of the golden parachute compensation will be required to be quantified in a new table for each named executive officer. The quantification applies only to incremental amounts related to the change in control transaction; it would not include amounts that are vested and set forth in the Pension Benefits or Nonqualified Deferred Compensation tables, or vested equity awards. Neither disclosure nor quantification would be required with respect to bona fide employment agreements to be entered into in connection with the change in control transaction that would be effective on or after the date the transaction occurs.

The narrative disclosure must describe the specific circumstances that would trigger the payment, who would make the payment, whether the payment would (or could) be in a lump sum or installments (and the duration of the installments), as well as any material conditions or obligations applicable to the payment (e.g., non-compete, non-solicitation, non-disparagement and confidentiality agreements), the duration of the conditions or obligations, and provisions relating to waiver or breach of the conditions or obligations.

There would be seven columns in the table with a dollar amount for each element:

- Cash – severance payments (e.g., salary, bonus, and pro rata bonus)
- Equity – dollar value of accelerated vesting of stock options and other equity awards<sup>1</sup>, and cash payments in cancellation of awards
- Pension/NQDC – enhancements to pension benefits and nonqualified deferred compensation
- Perquisites/Benefits – perquisites and other personal benefits, and health and welfare benefits
- Tax Reimbursement – tax reimbursements; primarily the “golden parachute excise tax gross-up”
- Other – any compensation element not specifically included in the other columns
- Total – the total of all of the elements

The proposed rules require inclusion of a footnote to each column specifying the amount attributable to “single-trigger” arrangements (payment on the change in control transaction) and “double-trigger” arrangements (payment on account of termination of employment without cause or for good reason within a specified time period following the change in control transaction). If disclosure is required relating to agreements and understandings of named executive officers with the acquiring company, two tables are required: one for amounts relating to all agreements and understandings (i.e., with either the acquiring company or the target company) and a

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<sup>1</sup> For options the amount is equal to the difference between the closing price as of the latest practicable date and the exercise price. For other equity awards the amount is equal to the closing price as of that date.

separate table for amounts relating only to agreements and understandings with the target company.

### **Say on Parachute Vote**

Shareholders must be provided with a separate non-binding vote on approval of the golden parachute compensation in the proxy approving the transaction, unless the agreement or understanding has previously been subject to a Say on Pay Vote on named executive officer compensation (i.e., the golden parachute compensation was included in a proxy statement disclosure of named executive officer compensation that was approved by shareholders in a Say on Pay Vote).

The vote is not required until the SEC rules are effective, which is expected to be on or close to the January 21, 2011 effective date for the Say on Pay and Say on Frequency Votes. The rules do not prescribe the wording of the form of the Say on Parachute resolution to be voted on by shareholders.

Although disclosure of agreements or understandings for golden parachute compensation between the acquiring company and the named executive officers of the target company is required, approval of such agreements and understandings is not required to be subject to the shareholder advisory vote.

It is important to note that, in order for the exception for golden parachute compensation subject to a prior Say on Pay Vote to apply, the new disclosure requirements discussed above for golden parachute compensation must have been satisfied at the time of the prior Say on Pay Vote. This presents the company with a choice – it can continue to describe change in control arrangements in compliance with the current SEC rules (which require less information than the new rules) but, if it does so, its description will likely not comply with the disclosure requirements of the new Say on Parachute Vote rules. Alternatively, it can comply with the new table and description requirements of the new SEC rules if it wants to avoid, at least in part, a second vote regarding the golden parachute compensation.

In deciding whether to modify its current disclosures regarding golden parachute compensation, a company should take into account the fact that the exception for arrangements subject to a prior Say on Pay Vote is limited to the agreements and understandings subject to the prior Say on Pay Vote and does not apply to the extent they have been modified. As a result, new and revised agreements and understandings must be submitted to a shareholder advisory vote at the time of the change in control transaction.

To the extent that new and revised agreements and understandings are submitted for a vote, the golden parachute compensation disclosure must contain two tables: one for all golden parachute compensation and one only for golden parachute compensation under new and revised agreements and understandings (which are the only arrangements subject to the Say on Parachute Vote).

According to the proposed rules, new equity awards not subject to a prior Say on Pay Vote would not be covered by the exception, even if they had the same terms as awards subject to a prior Say on Pay Vote, and would be required to be subject to a Say on Parachute Vote at the time of the change in control transaction. If this aspect of the proposed rules is not changed when the rules are finalized, it would substantially lessen the advantage of including golden parachute compensation in a Say on Pay Vote since the requirement for an advisory shareholder vote would still apply to some of the golden parachute compensation.

### **Comments**

Comments on the proposed rules may be submitted to the SEC on or before November 18, 2010. Over 50 specific requests for comments have been set forth by the SEC in connection with the proposed rules. It is expected that the SEC will adopt the final rules by the end of the year.

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This letter is intended to alert compensation professionals about developments that may affect their companies and should not be relied on as providing specific company advice. Specific questions about the Act should be discussed with appropriate legal counsel. General questions about this letter may be directed to Richard Alpern in our New York offices at 212-299-3599 or by e-mail at [ralpern@fwcook.com](mailto:ralpern@fwcook.com), or David Gordon in our Los Angeles office at 310-734-0111 or by e-mail at [degordon@fwcook.com](mailto:degordon@fwcook.com). Copies of this letter and other published materials are available on our website, [www.fwcook.com](http://www.fwcook.com).