

# CORPORATE AND SECURITIES LAW ALERT

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

## Proxy Update: SEC Adopts Final Rules on Say-on-Pay

January 27, 2011

On Tuesday, January 25, 2011, the Securities & Exchange Commission (“SEC”) adopted [final rules](#) relating to shareholder approval of executive compensation and “golden parachute” compensation. The final rules were originally [proposed](#) last October and implement Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “[Dodd-Frank Act](#)”). The final rules require public companies subject to the federal proxy rules to provide their shareholders with an advisory vote on the compensation of the executive officers as disclosed in their proxy (“Say-on-Pay”), an advisory vote on the frequency of the Say-on-Pay vote (“Say-When-on-Pay”) and an advisory vote on any compensation arrangements or understandings with certain executive officers in connection with certain merger or acquisition transactions that are subject to a shareholder vote (“Say-on-Golden-Parachutes”).

Under the Dodd-Frank Act, Say-on-Pay and Say-When-on-Pay votes are required for annual meetings of shareholders held on or after January 21, 2011. Although the SEC’s final rules are not effective until 60 days following publication in the Federal Register, companies should use the final rules as a guide in structuring their Say-on-Pay and Say-When-on-Pay disclosures during the 2011 proxy season. The Say-on-Golden-Parachutes requirements apply to proxy statements and other related statements and forms filed on or after April 25, 2011.<sup>1</sup> The following summary highlights a number of the provisions appearing in the final rules.

**Say-on-Pay:** As directed by Section 951 of the Dodd-Frank Act, the final rules require that a Say-on-Pay vote be conducted at least once every three calendar years beginning with the first annual shareholders’ meeting at which proxies will be solicited for the election of directors, or a special meeting in lieu of such annual meeting, taking place on or after January 21, 2011. In particular, the final rules provide the following:

- No preliminary proxy is required for a Say-on-Pay vote.
- Companies must disclose within their proxy statements that they are required to provide the Say-on-Pay vote pursuant to the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and explain the general effect of the Say-on-Pay vote, including whether the vote is non-binding.

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<sup>1</sup> Smaller reporting companies are exempted from the Say-on-Pay and Say-When-on-Pay requirements for two years (such requirements will apply to shareholders’ meetings on or after January 21, 2013); however, there is no such exemption for the Say-on-Golden-Parachutes provision.

- Companies are required to provide a separate resolution within the proxy for the Say-on-Pay vote.<sup>2</sup>

**Say-When-on-Pay:** In accordance with Section 951 of the Dodd-Frank Act, the final rules require that issuers provide a separate shareholder advisory vote at least once every six calendar years in proxy statements for annual or other meetings of shareholders to determine whether the Say-on-Pay vote will occur every one, two or three years. Additionally, the final rules provide the following:

- As with Say-on-Pay, no preliminary proxy is required.
- Also like Say-on-Pay, companies must disclose within their proxy statements that they are required to provide the Say-When-on-Pay vote pursuant to the Exchange Act and explain the general effect of the Say-When-on-Pay vote, including whether the vote is non-binding.
- Although companies are required to provide a separate resolution within their proxy statements for the Say-When-on-Pay vote, unlike its treatment of Say-on-Pay, the SEC did not provide any specific language for or examples of such a resolution.
- Company recommendations for the frequency of Say-on-Pay votes must make clear that shareholders are not voting to approve or disapprove a company's recommendation, but are instead choosing among four distinct options (one, two or three years, or abstain) as reflected on the proxy card.
- If a company adopts the frequency choice supported by a majority of shareholders in the most recent Say-When-on-Pay vote, that company may exclude future shareholder proposals relating to both Say-on-Pay and Say-When-on-Pay votes.<sup>3</sup>
- Through an amendment to the Form 8-K disclosing the voting results of the annual meeting, and no later than 150 days following the annual meeting at which the Say-When-on-Pay vote occurred,<sup>4</sup> a company must disclose its decision regarding how frequently it will conduct a Say-on-Pay vote.<sup>5</sup>

**Say-on-Golden-Parachutes:** As further directed by Section 951 of the Dodd-Frank Act, the final rules require public companies to disclose any written or oral agreements or understandings with certain named executive officers in connection with certain significant corporate transactions,

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<sup>2</sup> The final rules provide some flexibility in this regard and do not require companies to use any specific form of resolution to be voted on by shareholders; however, the final rules do require the Say-on-Pay resolution to indicate that its purpose is "to approve the compensation of the registrant's named executive officers as disclosed [in the proxy]." The SEC provided the following non-exclusive example that would satisfy the requirements of the final rules:

"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."

<sup>3</sup> The final rules differ from the proposed rules, which would have allowed such exclusion if a company adopted the frequency supported by a plurality, rather than a majority, of shareholders.

<sup>4</sup> But in no event may this disclosure be later than 60 calendar days prior to the deadline for the submission of shareholder proposals for the subsequent annual meeting, as disclosed in the issuer's proxy materials for the meeting at which the Say-When-on-Pay vote occurred.

<sup>5</sup> The rules as originally proposed called for amendments to Form 10-K and Form 10-Q to require such disclosure.

including mergers, acquisitions, consolidations, Rule 13e-3 going private transactions, and third party tender offers.

In addition to the required golden parachute compensation disclosures, public companies must also hold a Say-on-Golden-Parachutes vote at shareholders' meetings where shareholders are asked to approve certain corporate transactions, unless such compensation arrangements were previously subject to a Say-on-Pay vote.<sup>6</sup> This vote must be provided to shareholders through a separate resolution within the proxy statement, but the final rules do not require the use of any specific language or form of resolution.

**Say-When-on-Pay Current Trends and Analysis:** Proxy advisors and institutional shareholders (including Institutional Shareholder Services Inc. ("ISS") and Fidelity Investments) have adopted guidelines in support of annual Say-on-Pay votes. These supporters maintain that annual votes provide the highest level of accountability and communication between a company and its shareholders. Supporters of annual votes further argue that, absent an annual vote, institutional shareholders may be more inclined to express dissatisfaction with executive compensation policies through increased withhold/against votes for compensation committee or board members up for re-election in the years in which there is no Say-on-Pay vote. However, ISS has indicated in a recent FAQ that a recommendation by management that shareholders approve biennial or triennial Say-on-Pay votes would not trigger a negative recommendation by ISS for other proxy proposals.

Despite the support of proxy advisory firms for annual votes, as of January 21, 2011, approximately 56% of companies that filed definitive or preliminary proxy statements for annual meetings of shareholders to be held on or after January 21, 2011 recommended a triennial Say-on-Pay vote, as opposed to approximately 29% recommending an annual vote, 8% recommending a biennial vote and 7% with no preference. Proponents of triennial votes maintain that less frequent votes allow shareholders to better judge company compensation programs that incentivize and reward executive performance over multiple-year periods. Triennial votes also provide issuers with more time to consider the results of previous Say-on-Pay votes and implement thoughtful changes in response to shareholders' opinions. Alternatively, a biennial vote incorporates many of the positive features of annual and triennial votes while limiting the perceived deficiencies of each.

Some commentators suggest that the current trend of recommending triennial Say-on-Pay votes more often than annual votes may eventually flip, and recommendations for annual votes may become more prevalent as the proxy season progresses and the results of early shareholder votes begin to influence the recommendations of companies holding later annual meetings. One notable vote occurred this week at the annual shareholders' meeting of an S&P 500 company with a large institutional shareholder base, where 62% of shareholders voted in favor of annual Say-on-Pay votes, despite the company's recommendation for triennial votes, which received approximately 36% of the votes. As the 2011 proxy season progresses, we will continue to monitor Say-When-on-Pay recommendations and voting trends.

Bass, Berry & Sims PLC's Executive Compensation Subgroup is comprised of tax and corporate attorneys who monitor and advise on developments in the tax rules, securities laws and corporate governance standards relating to executive compensation. If you have any questions regarding the issues addressed in this Corporate and Securities Law Alert or if you would like to set up a meeting with us and your management team or board of directors regarding these developments, please feel

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<sup>6</sup> Despite this exception, we are unaware of any companies thus far who have disclosed golden parachute arrangements in their proxy for purposes of subjecting such arrangements to a Say-on-Pay vote, in an apparent effort to avoid a future Say-on-Golden-Parachutes vote.

free to communicate with your regular contacts in our Corporate and Securities Group or any of the attorneys in our Subgroup listed below.

**Todd Rolapp** 615-742-6288 [trolapp@bassberry.com](mailto:trolapp@bassberry.com)  
Executive Compensation Subgroup

**Jamie Wade** 615-742-7946 [jwade@bassberry.com](mailto:jwade@bassberry.com)  
Executive Compensation Subgroup

**Michael Carr** 615-742-7949 [mcarr@bassberry.com](mailto:mcarr@bassberry.com)  
Executive Compensation Subgroup

**Aryn Subhawong** 615-742-7916 [asubhawong@bassberry.com](mailto:asubhawong@bassberry.com)  
Executive Compensation Subgroup

**Paige Reber** 615-742-7926 [preber@bassberry.com](mailto:preber@bassberry.com)  
Executive Compensation Subgroup

#### Bass, Berry & Sims PLC Corporate and Securities Group

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