

Meridian Client Update

October 29, 2010

SEC Issues Proposed Rules on Say on Pay, Say on Vote Frequency and Say on Golden Parachutes

On Monday, 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 (the “Dodd-Frank Act”) relating to shareholder approval of a company’s executive compensation programs (“Say on Pay”), frequency of Say on Pay voting (“Say on Vote Frequency”) and golden parachute compensation arrangements (“Say on Golden Parachutes”). The proposed rules also provide guidance on the required disclosure of golden parachute arrangements that are subject to a shareholder vote. The comment period on these proposed rules ends November 18, 2010.

Highlights of the Proposed Rules

- Companies will **not** be required to file preliminary proxy statements with the SEC solely due to Say on Pay and Say on Vote Frequency resolutions appearing in the proxy statements.
- With regard to Say on Vote Frequency, shareholders must be given four choices on a single proxy ballot: whether Say on Pay voting should occur every 1, 2 or 3 years or to abstain. Boards may recommend to shareholders a company’s preference.
- If a company implements the results of the most recent Say on Vote Frequency vote, the company may exclude from its proxy material **shareholder proposals** relating to Say on Pay and Say on Vote Frequency.
- The required golden parachute disclosure is more robust than required under existing proxy rules and must be included in proxies soliciting shareholder approval of a merger or other similar transactions regardless of whether shareholders are voting on a company’s golden parachute arrangements.
- Neither the Say on Golden Parachute vote requirement nor the disclosure of golden parachute arrangements will be effective until the SEC adopts final rules on the disclosure of golden parachutes.
- An exception to the Say on Golden Parachute vote requirement is provided if (i) a golden parachute arrangement was previously disclosed (**based on the proposed and more expansive disclosure rules**) as part of a company’s executive compensation proxy disclosure and (ii) the disclosed executive compensation was subject to a prior Say on Pay vote.

Say on Pay

Under the Dodd-Frank Act, a public company’s shareholders must be allowed to make a non-binding advisory vote on the company’s executive compensation as disclosed in its proxy materials. The initial shareholder vote must occur at the first shareholder meeting occurring on or after January 21, 2011. Thereafter, this vote is required at least once every three years. The proposed rules expressly provide that compensation paid to directors is not subject to a shareholder vote.

The Dodd-Frank Act does not direct the SEC to promulgate rules on Say on Pay. The fact that the SEC has engaged in rulemaking does not alter the effective date of Say on Pay.

The proposed rules do **not** require companies to use any specific language or form of Say on Pay resolution to be voted on by shareholders. However, the shareholder vote must relate to all compensation required to be disclosed pursuant to Item 402 of Regulation S-K. **This covers compensation disclosed in the Compensation Discussion and Analysis (“CD&A”), the Summary Compensation Table, all supplementary compensation tables and other narrative compensation disclosures.** Not covered by the shareholder vote are company-wide compensation policies and practices that relate to risk management and risk taking incentives disclosed pursuant to Item 402(s) of Regulation S-K. This exclusion from Say on Pay voting is consistent with the fact that the disclosure on risk is not required to appear in a company’s CD&A.

The proposed rules would require companies to disclose in their proxy statements for annual meetings, (i) a statement that a separate shareholder vote on executive compensation is included in the proxy and (ii) a brief explanation of the general effect of the vote, such as the vote is non-binding. In addition, companies would be required to address in their CD&A whether and, if so, how their compensation policies and decisions have taken into account the results of Say on Pay voting.

Say on Pay voting would *not* trigger the requirement that companies file a preliminary proxy statement.

Meridian Commentary. The proposed rules give companies substantial flexibility regarding how to craft the advisory vote resolution on executive compensation. This approach is consistent with the one taken by the SEC with respect to TARP recipients who have been subject to Say on Pay requirements since 2009. However, we fully expect most Say on Pay votes to look very similar. Additionally, since the Say on Pay vote will not trigger the obligation that companies file a preliminary proxy statement with the SEC; companies will have ten additional days to prepare their filing (assuming that the proxy does not contain any other subject matter that triggers a preliminary filing).

With the 2011 proxy season imminent, companies should begin to take steps to prepare for Say on Pay voting, including a comprehensive review of their pay and corporate governance practices and policies. At a minimum, companies should obtain a thorough understanding of the proxy voting policies on executive compensation and Say on Pay of their major institutional shareholders and their advisors. As we have previously noted, due to the ban on non-directed broker voting on executive compensation, major shareholder advisory firms and activist shareholders may have the ability to broadly influence voting patterns on Say on Pay. See Meridian’s Client Update Vol. 1, Issue 10, dated July 16, 2010.

Say on Vote Frequency

Under the Dodd-Frank Act, a public company’s shareholders must be allowed to make a non-binding advisory vote on whether the shareholder vote on the company’s executive compensation should occur every 1, 2 or 3 years. The initial shareholder vote must occur at the first shareholder meeting occurring on or after January 21, 2011. Thereafter, this vote is required at least once every six years.

The Dodd-Frank Act does not direct the SEC to promulgate rules on Say on Vote Frequency. The fact that the SEC has engaged in rulemaking does not alter the effective date of Say on Vote Frequency.

The proposed rules clarify the proxy ballot mechanics of say-on-vote-frequency. Under existing rules, each vote frequency choice would be subject to a separate shareholder vote. The proposed rules would treat these choices as a single matter, subject to a single shareholder vote. Specifically, the shareholders must be given four choices on a single proxy ballot: whether the shareholder vote on executive compensation should occur every 1, 2, or 3 years, or to abstain from voting. The proposed rules expressly prohibit alternative formulations, such as proposals that would provide shareholders with two substantive choices (e.g., to hold a Say on Pay every year or every three years). Board of directors may include in proxy materials a **recommendation on Say on Vote-Frequency**, provided that the proxy ballot clearly indicates that shareholders are not voting to approve or disapprove the board’s recommendation.

As with Say on Pay, the proposed rules would require companies to disclose in their proxy statements (i) a statement that a separate Say on Vote Frequency resolution is included in the proxy and (ii) a brief explanation of the general effect of this vote, such as the vote is non-binding. Additionally, companies would be required to address in their CD&A whether and, if so, how their compensation policies and decisions have taken into account the results of Say on Vote Frequency voting. The proposed rules also would require a company to report on Form 10-Q (or Form 10-K if the shareholder vote occurs during a company's fourth quarter) its decision regarding how frequently to conduct Say on Pay voting in light of Say on Vote Frequency results.

As in the case with Say on Pay voting, Say on Frequency voting would not trigger the requirement that a company file a preliminary proxy statement with the SEC.

Meridian Commentary. At this point, it is unclear what voting preferences will emerge among institutional shareholders. The preferences of many institutional shareholders will clearly be shaped by the positions the major proxy advisory firms (especially ISS) take on Say on Vote Frequency. So far, the major proxy advisory firms have yet to take any formal position; however, many expect they may have a preference for more frequent voting on executive pay matters, which affords them more leverage and real-time response to perceived problematic pay practices. Given that this upcoming proxy season represents the first time shareholders will vote on Say on Frequency, boards will be in a unique position to present a business case to shareholders for their preferred voting outcome.

Proposed Amendment to Rule 14a-8

In connection with both Say on Pay and Say on Vote Frequency, the SEC is proposing to amend Rule 14a-8 to clarify the status of shareholder proposals that seek an advisory shareholder vote on executive compensation or that relate to the frequency of shareholder votes approving executive compensation. Rule 14a-8 provides eligible shareholders with an opportunity to include a proposal in a company's proxy materials for a vote at an annual or special meeting of shareholders. A company generally is required to include the proposal unless the shareholder has not complied with the rule's procedural requirements or the proposal falls within one of the rule's 13 substantive bases for exclusion. One of the substantive bases for exclusion, Rule 14a-8(i)(10), provides that a company may **exclude** a shareholder proposal that has already been substantially implemented.

Under the proposed amendment to Rule 14a-8, if a company implements the results of the most recent vote on Say on Vote Frequency, the company would be permitted to exclude from its proxy materials a shareholder proposal that would provide a Say on Pay vote or seeks future Say on Pay votes or that relates to the frequency of say-on-pay votes on the basis that such shareholder proposals have already been substantially implemented.

For example, if in the first Say on Frequency Vote the largest number of votes were cast for Say on Pay voting to occur every two years and the company discloses that it has approved a policy to hold Say on Pay votes every two years, a shareholder proposal seeking a different frequency could be **excluded** so long as the company provides a Say on Pay vote every two years and provides a Say on Frequency Vote at least every six years.

Disclosure and Voting Requirements Relating to Golden Parachutes

The Dodd-Frank Act requires that in any proxy or consent solicitation material ("merger proxy") which seeks shareholder approval of an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all the assets of a public company ("Corporate Transaction") the person making such solicitation must disclose in the merger proxy golden parachute arrangements payable to named executive officers in connection with a Corporate Transaction. The Dodd-Frank Act further requires that a company's shareholders be allowed to make a non-binding advisory vote on the company's golden parachute arrangements that are disclosed in a merger proxy. This vote is not required if the golden parachute arrangement was previously included in the company's executive pay disclosure which was subject to a shareholder vote.

Effective Date of Disclosure and Vote on Golden Parachute Arrangements

Unlike Say on Pay and Say on Vote Frequency, the effective date of the Say on Golden Parachutes and the related disclosure requirement is contingent upon future rulemaking by the SEC. This is not apparent under the Dodd-Frank Act which expressly requires that a vote on golden parachute Arrangements must be included in merger proxies for meetings of shareholders occurring on or after January 21, 2011 at which shareholders are voting on a Corporate Transaction. However, the Dodd-Frank Act also directs the SEC to promulgate rules on the content of the required golden parachute disclosures (the SEC is under no statutory deadline by which to issue these rules). In the proposed rules, the SEC has interpreted these two provisions to mean that a separate resolution to approve golden parachute arrangements (and related disclosure) would not be required **until the effective date of the SEC's final disclosure rules** on golden parachute arrangements.

Meridian Commentary. Say on Golden Parachute arrangements' delayed effective date certainly caught many by surprise. According to the SEC's published rulemaking calendar, it expects to adopt final rules between January and March of 2011. Under this schedule, it is possible that final rules may not become effective until late spring of 2011. However, the SEC may feel pressure to adopt final rules shortly after the comment period ends on November 18, 2010.

Disclosure of Golden Parachute Arrangements

The Dodd Frank Act requires that the disclosure of golden parachute arrangements in merger proxies cover the following matters:

- Any agreements or understandings with any named executive officers of any type of compensation (whether present, deferred or contingent) that is based on or otherwise relates to a Corporate Transaction; and
- The aggregate total of all such compensation that may (and the conditions upon which it may) be paid or become payable to or on behalf of such executive officers.

The SEC considered and rejected the notion of simply making the disclosure requirements in Item 402(j) of Regulation S-K (i.e., the disclosure rules relating to potential post-employment payments) applicable to Corporate Transactions as an appropriate approach to satisfy the golden parachute disclosure requirement. The SEC noted that certain elements of the disclosure required under the Dodd-Frank Act are not required under Item 402(j). Therefore, the SEC has proposed new Item 402(t) that requires **significantly greater** detail of disclosure than is required under Item 402(j).

It is important to note that under existing rules companies are already required to disclose information on golden parachute arrangements in their merger proxies. Often these disclosures are fairly robust, particularly ones made by large companies, but generally these disclosures do not provide the level of detail required under proposed Item 402(t).

The cornerstone of proposed Item 402(t) is the requirement that companies provide the following tabular disclosure of golden parachute arrangements in proxy or soliciting materials seeking shareholder approval of a Corporate Transaction, **regardless of whether the golden parachute arrangements are subject to a shareholder vote:**

Name	Cash (\$)	Equity (\$)	Pension / NQDC (\$)	Perquisites/ Benefits (\$)	Tax Reimbursement (\$)	Other (\$)	Total (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
PEO							
PFO							
A							
B							
C							

The proposed rules provide the following explanation of the types of compensation that would be required to be disclosed in each column of the table:

- **Cash column.** The amount of any cash severance payment (e.g., base salary, annual bonus, and pro-rata non-equity incentive plan compensation payments).
- **Equity column.** The dollar value of accelerated stock awards, in-the-money option awards for which vesting would be accelerated and payments in cancellation of stock and option awards.
- **Pension/NQDC column.** The value of enhancements to pension and nonqualified deferred compensation benefits.
- **Perquisites/Benefits column.** The value of any perquisites and other personal benefits and health and welfare benefits.
- **Tax reimbursement column.** The amount of any tax reimbursements (e.g., 280G tax gross-ups).
- **Other column.** The amount of any other compensation not specifically covered under the foregoing items.
- **Total column.** The aggregate total of compensation disclosed in the preceding columns.

The tabular disclosure of golden parachute arrangements would require separate footnote identification of amounts attributable to “single trigger” arrangements and amounts attributable to “double trigger” arrangements.

Companies would also be required to describe any material conditions or obligations applicable to the receipt of any golden parachute payment, including but not limited to non-compete, non-solicitation, non-disparagement or confidentiality agreements, their duration, and provisions regarding waiver or breach.

In proxy statements for annual shareholder meetings at which shareholders are **not** voting on a Corporate Transaction, the disclosure of golden parachute arrangements remains subject to the more limited requirements of Item 402(j) (however, see discussion below regarding incentives for companies to always include their proxy the more expansive disclosure required under Item 402(t)).

Meridian Commentary. The greater disclosure required under Item 402(t) than under the existing proxy rules will likely increase the already intense scrutiny of golden parachute arrangements. This may result in the acceleration of design trends that have emerged over the last few years, such as the elimination of tax-gross-ups in favor of modified tax cutbacks, moderation in the level of cash severance benefits and inclusion of “double triggers” for the acceleration of vesting of outstanding equity awards. These required disclosures also give institutional shareholder advisory groups, like ISS, a road map to push program design issues, like single trigger vesting on equity incentives.

Say on Golden Parachutes Vote Requirements

Golden parachute arrangements disclosed in a merger proxy are **not** subject to a shareholder vote if the arrangements were previously included in a company’s executive compensation disclosure that was subject to a prior shareholder vote. The proposed rules make clear that this exception to the voting requirement remains even if the prior Say on Pay vote did **not** approve the company’s executive compensation programs. However, the exception would not be available unless the prior disclosure of the golden parachute arrangements complied with the more expansive requirements of proposed Item 402(t) as described above (compliance with 402(j) would not be sufficient).

The proposed rules do **not** require companies to use any specific language or form of Say on Golden Parachute resolution to be voted on by shareholders.

New golden parachute arrangements or any revisions to golden parachute arrangements that were subject to a prior Say on Pay vote would be subject to a separate shareholder vote. Under the proposed rules, a company would be required to provide two separate tables under Item 402(t) in its merger proxy. One table would disclose all golden parachute compensation, including both arrangements and amounts previously disclosed and subject

to a prior Say on Pay voting and new arrangements or revised terms of previously voted on arrangements. The second table would disclose only new golden parachute arrangements or revised terms of an existing golden parachute arrangement previously subject to a Say on Pay vote.

***Meridian Commentary.** The proposed rules create a significant incentive for companies to voluntarily include Item 402(t) disclosures in their annual proxies. By making this disclosure, a company would avoid the necessity of subjecting their golden parachute arrangements to a shareholder vote. This exception to the golden parachute vote requirement would not apply to newly adopted golden parachute arrangements that were not subject to a previous Say on Pay vote or to revisions to an existing arrangement that was subject to a prior Say on Pay vote.*

Transition Rules Applicable Until the SEC Adopts Final Rules

The SEC is providing the following transition rules for companies whose next shareholder meeting will occur on or after January 21, 2011 but prior to the date the SEC adopts final rules:

- Companies will not be required to file a preliminary proxy statement with the SEC if the only matters on the proxy statement relate to Say on Pay and Say on Vote Frequency (without this transition relief, affected companies would be required to file a preliminary proxy statement); and
- With regard to the Say on Vote Frequency, companies may allow shareholders to cast an advisory vote on a single proxy ballot as to whether vote frequency on Say on Pay should occur every 1, 2 or 3 years or to abstain from voting (without this transition relief, affected companies would be required to permit shareholders to vote separately on each vote frequency choice).

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