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PUBLIC COMPANY UPDATE

SEC Issues Proposed Say-on-Pay Rules

OVERVIEW

On October 18, the SEC released its proposed say-on-pay rules implementing the requirements of Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). The comment period on the proposed rules closes November 18. Under the proposed rules, public companies subject to the federal proxy rules would be required to provide their shareholders with a non-binding advisory vote on executive compensation at least once every three years and at least every six years with a non-binding advisory vote on the desired frequency of say-on-pay votes. In addition, the proposed rules would require companies to provide shareholders with a non-binding advisory vote on golden parachute arrangements in connection with merger and similar transactions and additional disclosures regarding such arrangements in merger proxy statements.

As the Dodd-Frank Act requires, the say-on-pay rules will apply to proxy statements for a company’s first shareholder meeting occurring on or after January 21, 2011, whether or not the SEC’s final rules are in effect by then. You can find the full text of the proposed rules at www.sec.gov/rules/proposed/2010/33-9153.pdf.

SHAREHOLDER VOTE ON EXECUTIVE COMPENSATION

Say-on-Pay Proposal

Proposed Rule 14a-21(a) would require companies to conduct an advisory shareholder vote on executive compensation at least once every three years. The shareholder vote would only be required when proxies are solicited for an annual or other shareholder meeting for which the SEC’s rules require disclosure of executive compensation.

Although the SEC did not propose any specific language for the say-on-pay resolution, shareholders would vote on the compensation of the company’s named executive officers, as such compensation is disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis (CD&A), the compensation tables and other narrative compensation disclosures. The SEC emphasized that the vote must encompass all of the executive compensation disclosure required by Item 402. Director compensation and compensation risk policies, however, would not be subject to the shareholder vote, except to the extent that compensation risk considerations are material aspects of the company’s compensation policies or decisions for named executive officers and are discussed in the CD&A.



Proposed Item 24 to Schedule 14A would require companies to disclose in their proxy statements that they are conducting a separate shareholder vote on executive compensation and to explain the general effect of the vote, indicating, for example, that the vote is non-binding.

Additional CD&A Disclosures

The proposed rules would require that companies discuss in their CD&A whether and, if so, how their compensation policies and decisions have taken into account the results of shareholder say-on-pay votes.

SHAREHOLDER VOTE ON FREQUENCY OF SAY-ON-PAY VOTES

Frequency of Say-on-Pay Proposal

Proposed Rule 14a-21(b) would require companies, not less than once every six years, to provide an advisory shareholder vote in annual meeting proxy statements to determine the desired frequency of the shareholder vote on executive compensation. The SEC clarified that companies must provide shareholders with four choices on a proxy card: whether the shareholder vote on executive compensation will be cast every one, two or three years, or to abstain from voting on the matter. Companies are expected to include the board of directors' recommendation as to frequency, but are not permitted to present shareholders with less than four choices and are not permitted to have shareholders vote to approve or disapprove the company's recommendation.

Proposed Item 24 to Schedule 14A would require companies to disclose in the proxy statement that they are conducting a separate shareholder advisory vote on the frequency of the say-on-pay votes and to explain the general effect of the frequency vote, indicating, for example, that the vote is non-binding.

Additional Form 10-Q/Form 10-K Disclosures

The SEC's proposed amendments would require companies to disclose, in the quarterly report on Form 10-Q or the annual report on Form 10-K covering the period in which the shareholder say-on-pay vote occurs, the company's decision, in light of the shareholder frequency vote, as to how often it will conduct shareholder votes on executive compensation in the future. This disclosure is focused on the company's decision and is in addition to the current requirement to report shareholder votes on a Form 8-K within four business days of the shareholder meeting.

SHAREHOLDER VOTE ON GOLDEN PARACHUTE ARRANGEMENTS

Current Item 402(j) Disclosure Insufficient

The Dodd-Frank Act also requires disclosure of, and a non-binding shareholder vote on, golden parachute arrangements in connection with merger and similar transactions. To implement this



requirement, the SEC has proposed additional disclosure of golden parachute arrangements in proxy statements, consent solicitation statements, registration statements on Form S-4 and other documents filed with the SEC in connection with merger or similar transactions in accordance with new Item 402(t) of Regulation S-K. In the SEC's view, the existing Item 402(j), which already applies to annual meeting proxy statements, is insufficient to comply with the Dodd-Frank Act because it does not specifically require disclosure in a tabular form, does not require disclosure of an aggregate total of all compensation related to a transaction, permits exclusion of *de minimis* perquisites and other personal benefits, and does not require disclosure of agreements and other arrangements that do not discriminate in favor of executive officers and are available to all salaried employees. Disclosures in annual meeting proxy statements remain subject to the requirements of Item 402(j), rather than Item 402(t), unless the company wishes to avoid a separate shareholder vote on golden parachute arrangements in connection with a subsequent merger or similar transaction by complying with Item 402(t) in the annual meeting proxy statement.

Exception From Separate Shareholder Vote on Golden Parachutes

A separate shareholder vote on golden parachutes in connection with a merger or similar transaction would not be required if the disclosure of that compensation had been included in the executive compensation disclosure that was subject to a prior shareholder say-on-pay vote, regardless of the outcome of the vote. This exception would be available only to the extent the golden parachute arrangements that were previously subject to the shareholder vote remain in effect and have not been modified. New or modified golden parachute arrangements would not be covered by this exception.

Companies seeking to satisfy the exception from the separate merger proxy shareholder vote by including Item 402(t) disclosure in an annual meeting proxy statement could satisfy parts of the Item 402(j) change-in-control disclosure requirements by providing Item 402(t) disclosure. These companies, however, would still need to include Item 402(j) disclosure of payments that may be made to named executive officers upon any termination of employment apart from a change in control.

Proposed Item 402(t)

The SEC did not propose a form of a specific resolution to be voted on by shareholders. Proposed Item 402(t) would require both tabular and narrative disclosure of named executive officers' compensation that is based on or otherwise relates to the transaction. The amounts in the table would be totaled, as required by the Dodd-Frank Act. The table would also require footnotes identifying amounts attributable to "single-trigger" arrangements (*i.e.*, amounts triggered by a change in control without an executive officer's termination) and amounts attributable to "double-trigger" arrangements. When Item 402(t) disclosure is included in an annual meeting proxy statement, the amounts would be calculated based on the closing market price per share of the company's stock on the last business day of the company's most recently completed fiscal year.



Companies would not be required to provide Item 402(t) information with respect to persons who would have been among the most highly compensated executive officers but for the fact that they were not serving as the company's executive officers at the end of the last completed fiscal year, for whom information otherwise is required by Item 402.

SMALLER REPORTING COMPANIES

No Exemption

The SEC did not propose to exempt smaller reporting companies from the shareholder votes on executive compensation, votes on frequency of say-on-pay votes or votes on golden parachute arrangements. In addition, although smaller reporting companies are not required to provide quantification of change-in-control or termination payments under current Item 402(q) of Regulation S-K, the SEC's proposed rules would require quantification of golden parachute arrangements in merger proxy statements. However, smaller reporting companies would not be required to include such quantification in their annual meeting proxy statements unless they seek to avoid a shareholder vote on golden parachute arrangements in a later merger transaction.

No CD&A Required

Smaller reporting companies would remain subject to scaled executive compensation disclosure requirements and would not be required to include the CD&A in their proxy statements. In addition, they would generally not be required to discuss if and how their compensation policies and decisions have taken into account the results of shareholder say-on-pay votes. However, if consideration of prior shareholder say-on-pay votes is a material factor necessary to an understanding of the information disclosed in the Summary Compensation Table, disclosure would be required pursuant to the current requirements set forth in Item 402(o) of Regulation S-K.

TARP COMPANIES

Companies that conduct an annual shareholder vote to approve executive compensation pursuant to the Emergency Economic Stabilization Act of 2008 would not be required to conduct a separate shareholder vote on executive compensation, or frequency of say-on-pay, pursuant to Proposed Rule 14a-21 until such companies have repaid all indebtedness under the Troubled Asset Relief Program (TARP). Such companies would be required to include a shareholder advisory vote on executive compensation and a shareholder advisory vote on the frequency of say-on-pay for the first annual meeting of shareholders after the company has repaid all outstanding indebtedness under TARP.



ADDITIONAL MATTERS

No Preliminary Proxy Statement Required

Proposed amendments to Rule 14a-6 would provide that shareholder votes on executive compensation and frequency of say-on-pay do not trigger a preliminary proxy filing requirement.

No Discretionary Broker Voting

The SEC confirmed that brokers may not cast discretionary votes on say-on-pay proposals or frequency of say-on-pay proposals.

Shareholder Say-on-Pay Proposals

The SEC's proposed rules permit companies to exclude shareholder proposals on say-on-pay or frequency of say-on-pay if the company has adopted a policy on the frequency of say-on-pay votes that is the same as the voting frequency that received the greatest number of votes in the most recent advisory vote on the frequency of say-on-pay votes and provides a vote on frequency at least once every six years.

TRANSITION MATTERS

No Preliminary Proxy Required

Any definitive or preliminary proxy statements relating to a shareholder meeting occurring on or after January 21, 2011 (even if filed prior to this date) must include resolutions for both the initial shareholder vote on executive compensation and the initial shareholder vote on the frequency of say-on-pay votes, whether or not the SEC's final rules are in effect by that time. While the rules are being implemented, the SEC will not object if companies do not file preliminary proxy materials if the only matters that would require a preliminary filing are the say-on-pay vote and the frequency of say-on-pay votes.

Proxy Card

While the rules are being implemented, the SEC will not object if the proxy card for a shareholder vote on the frequency of say-on-pay votes provides an option to specify by boxes a choice among one, two or three years, or abstain (which current SEC rules do not permit). In addition, if proxy service providers are not able to accommodate four choices on the proxy card during the transition period, the SEC will not object if the proxy card provides an option to specify by boxes a choice among one, two or three years, and proxies are not voted on the frequency of say-on-pay matter if the shareholder does not select a choice among one, two or three years.



OVERALL IMPLICATIONS

- Although expected, the SEC's proposed elimination of the requirement to file a preliminary proxy statement for the inclusion of say-on-pay and frequency of say-on-pay votes provides relief to companies with tight annual meeting timelines.
- The SEC's clarification of the proxy card format for a say-on-pay resolution will enable companies to commence preparations with their transfer agent and Broadridge to implement the new requirements.
- In light of the SEC's belief that current change-in-control disclosures pursuant to Item 402(j) would be insufficient to cover the golden parachute disclosures mandated by the Dodd-Frank Act, companies will need to consider whether to include expanded change-in-control disclosures in their annual meeting proxy statements in order to avoid a separate shareholder vote on golden parachutes in case of a merger or similar transaction.
- Smaller reporting companies will need to consider how to present say-on-pay resolutions taking into account that their proxy statements do not include the CD&A.
- Companies will need to add the enhanced CD&A, Form 10-Q/10-K and other additional disclosure requirements to their annual meeting checklists.

FOR MORE INFORMATION

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