

## SEC Proposal on TARP “Say on Pay” Votes; Non-TARP Companies Should Also Take Heed

July 10, 2009

On July 1, the Securities and Exchange Commission (the SEC) proposed new Rule 14a-20 of the proxy rules and amendments to Item 20 of Schedule 14A under the Securities Exchange Act of 1934, as amended, to set forth requirements relating to the solicitation of nonbinding shareholder approval of executive compensation by companies that participate in the Troubled Asset Relief Program (TARP).<sup>1</sup> Public comments on the proposals must be received by the SEC on or before September 8, 2009.

The SEC proposals would implement Section 7001 of the American Recovery and Reinvestment Act of 2009 (ARRA),<sup>2</sup> which amended Section 111 of the Emergency Economic Stabilization Act of 2008 (EESA),<sup>3</sup> to require any recipient of financial assistance under TARP to solicit nonbinding shareholder approval of “the compensation of executives, as disclosed pursuant to the compensation disclosure rules of the Commission (which disclosure shall include the compensation discussion and analysis, the compensation tables, and any related material).” Although the SEC proposals apply only to TARP recipients, other non-TARP companies should also be interested in these proposals.

**New Rule 14a-20.** Under proposed Rule 14a-20, during any period in which a TARP recipient has outstanding obligations arising from financial assistance received under TARP, the TARP recipient must provide a separate nonbinding shareholder vote to approve the compensation of executives, as disclosed pursuant to Item 402 of Regulation S-K, including the compensation discussion and analysis (CD&A), compensation tables, and related materials, at any annual meeting (or special meeting in lieu of an annual meeting) where shareholders will vote on the election of directors.<sup>4</sup>

1. SEC Release No. 34-60218; File No. S7-12-09, “Shareholder Approval of Executive Compensation of TARP Recipients” (July 1, 2009), available at <http://www.sec.gov/rules/proposed/2009/34-60218.pdf>.
2. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115, signed into law on February 17, 2009.
3. Emergency Economic Stabilization Act of 2008, 12 U.S.C. §§ 5201, et seq., signed into law on October 3, 2008.
4. Companies subject to proposed new Rule 14a-20 could still be required to include in their proxy statements proposals regarding “say on pay” submitted by shareholders. In *Bank of America Corporation* (March 11, 2009), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2009/ksteinerchevedden031109-14a8.pdf>, the SEC staff stated that it did not concur with the company’s view that it could exclude a “say on pay” shareholder proposal under Rule 14a-8 on the theory that the company was already required to put a “say on pay” resolution to a shareholder vote pursuant to the EESA. The shareholder proposal there called for the company to adopt a policy of annually submitting “say on pay” resolutions to shareholder votes.

TARP recipients that are smaller reporting companies, generally companies with a public float of less than \$75 million,<sup>5</sup> and which under SEC rules are not required to prepare CD&As, would solicit shareholder nonbinding approval of executive compensation pursuant to proposed Rule 14a-20 by reference to their compensation disclosure prepared in accordance with the rules applicable to smaller reporting companies.

**Amendment to Item 20 of Schedule 14A.** Under the proposed amendment to Item 20 of Schedule 14A, a TARP recipient must disclose in its proxy statement that it is providing a separate nonbinding shareholder vote on executive compensation pursuant to the EESA and briefly describe the general effect of the vote. The proposing release suggests that a company's disclosure of "whether the vote is nonbinding" would explain the "general effect of the vote." This seems strange, however, given that the EESA itself states that *all* "say on pay" shareholder votes mandated by it shall be *nonbinding*, and it is very unlikely that any given TARP recipient would voluntarily submit its executive compensation to a *binding* shareholder vote (even assuming such a binding vote would not violate the EESA).

Nevertheless, the SEC's suggested disclosure may be read to mean that the SEC did not intend to create a requirement similar to the separate requirement in Item 18 of Schedule 14A, applicable to matters voluntarily submitted to a shareholder vote, under which the company must describe what action it intends to take in the event of a negative vote on the matter. If Item 18 applied, as it may where a company voluntarily submits a "say on pay" vote to its shareholders, companies would also have to describe the actions that they would take upon a negative "say on pay" vote on their executive compensation.

**Other Issues.** In addition to the points discussed above, the proposals raise the following other important issues:

- **Form of Resolution.** In the proposing release, the SEC states that it will not require any specific language or form of shareholder resolution for the "say on pay" vote on executive compensation. However, the SEC notes that the vote must be to approve the compensation of executives; a vote to approve only compensation policies and procedures would not suffice.<sup>6</sup>
- **Filing of Proxy Statement in Preliminary Form.** The SEC clarifies in the proposing release that any proxy statement that includes a vote under proposed Rule 14a-20 must be filed in preliminary form with the SEC pursuant to Rule 14a-6. However, in its request for comments, the SEC asks whether it should amend Rule 14a-6 so that such a vote would not by itself require the company's proxy statement to be filed in preliminary form with the SEC.

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5. See Rule 12b-2, 17 C.F.R. § 240.12b-2.

6. One of the first "say on pay" resolutions voluntarily submitted to a nonbinding shareholder vote was of the latter type and would not suffice under the SEC proposals. That company resolution asked shareholders to "approve the overall executive pay-for-performance compensation policies and procedures employed by the Company, as described in the Compensation Discussion and Analysis and the tabular disclosure regarding named executive officer compensation (together with the accompanying narrative disclosure) in this Proxy Statement." See Aflac, Inc., 2008 Proxy Statement (filed March 18, 2008). "Say on pay" resolutions proposed by shareholders under Rule 14a-8 also often tend to focus on the company's policies and procedures.

- **Counting Votes.** The proposing release does not comment on how to count shareholder votes to determine whether a proposed Rule 14a-20 nonbinding shareholder “say on pay” vote has been approved; states differ as to whether all shares entitled to vote are counted, including abstentions, or only votes actually cast are counted.<sup>7</sup> Presumably, state law would control on this matter.
- **Prior SEC Staff Interpretations.** The proposing release does not comment on what effect, if any, the proposals would have on the SEC Division of Corporation Finance staff’s Compliance & Disclosure Interpretations regarding the ARRA (the C&DIs).<sup>8</sup> Proposed Rule 14a-20 and proposed amended Item 20 to Schedule 14A do not appear to conflict with these C&DIs.

**Implications for Non-TARP Companies.** During the open SEC meeting to discuss the proposals, Commissioner Elisse Walter expressed the view that all public companies subject to the SEC’s proxy rules should consider voluntarily submitting nonbinding “say on pay” resolutions on their executive compensation to shareholder vote, even though the SEC’s proposals would apply only to TARP recipients. Support for nonbinding shareholder “say on pay” votes on executive compensation is shared by others, including the Department of the Treasury, which has called for legislation to give the SEC explicit authority to require nonbinding annual “say on pay” votes for all public companies subject to the proxy rules, and members of Congress, who have introduced various bills to mandate that all public companies subject to the proxy rules submit a nonbinding “say on pay” vote to their shareholders.<sup>9</sup> In addition, during the 2009 proxy season, approximately 85 companies included in their proxy statements proposals for nonbinding “say on pay” votes submitted by shareholders pursuant to Rule 14a-8, and a growing number of companies have voluntarily put nonbinding “say on pay” resolutions on their management agendas for shareholder votes.<sup>10</sup>

Given this widespread pressure for nonbinding shareholder “say on pay” votes, there is a real possibility that legislation will soon be enacted mandating such “say on pay” votes at all public companies subject to the proxy rules, perhaps by next proxy season. Finally, even in the absence of legislation requiring a nonbinding shareholder “say on pay” vote, those companies that voluntarily submit such a vote to their shareholders should look to the SEC’s rules implementing the EESA for guidance on the disclosure and other issues outlined above.

If you would like more information on the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

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7. Under both vote-counting approaches, broker nonvotes have no effect. Under New York Stock Exchange Rule 452, brokers would likely not have discretionary authority to vote uninstructed customer shares in a “say on pay” vote, because such a vote would likely be considered a nonroutine matter. Nonetheless, there are some companies who have treated their voluntary nonbinding “say on pay” shareholder votes as routine matters for purposes of Rule 452.
  8. SEC Division of Corporation Finance, “Compliance & Disclosure Interpretations: American Recovery and Reinvestment Act of 2009” (February 26, 2009), available at <http://www.sec.gov/divisions/corpfin/cfguidance.shtml#arra>.
  9. See, e.g., Department of the Treasury, “Fact Sheet: Ensuring Investors Have a ‘Say on Pay’” (June 10, 2009); Excessive Pay and Shareholder Approval Act, S. 1006, 111th Cong. § 2 (2009), introduced by Senator Richard Durbin on May 7, 2009; Shareholder Bill of Rights Act of 2009, S. 1074, 111th Cong. § 14A (2009), introduced by Senators Charles Schumer and Maria Cantwell on May 19, 2009; Shareholder Empowerment Act, H.R. 2861, 111th Cong. § 16B (2009), introduced by Representatives Gary Peters, Maxine Waters, John Dingell, Peter Welch, Rush Holt, Peter DeFazio and Michael Capuano on June 12, 2009.
  10. *Risk & Governance Weekly*, “Preliminary Postseason Report” (June 12, 2009), available at [http://www.riskmetrics.com/governance\\_weekly/2009/357](http://www.riskmetrics.com/governance_weekly/2009/357).

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