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Smaller Reporting Companies Subject to Say-on-Pay Rules in the 2013 Proxy Season

The rules regarding the Say-on-Pay and Say-on-Frequency voting requirements that have been in effect for larger companies for the past two proxy seasons are now also applicable to smaller reporting companies ("SRCs"). SRCs enjoyed a temporary exemption but are now required to include the Say-on-Pay and Say-on-Frequency votes beginning with their proxy statements for the first shareholder meeting held on or after January 21, 2013 at which directors are elected and for which tabular executive compensation disclosure is required.

For SRCs, the inclusion of these votes in the annual proxy statement raises disclosure considerations that larger companies did not face. Because scaled-down disclosure options are available to SRCs, their executive compensation disclosure is typically reduced. For example, SRCs are not required and often do not include a Compensation Discussion and Analysis ("CD&A") section in their proxy statements. Larger companies are required to include a CD&A, which is where these companies set forth a description of their compensation philosophy and articulate details about their policies and procedures, such as how the company has sought to align pay with performance. Larger companies use the narrative discussion in the CD&A as a means to garner support for their Say-on-Pay proposals. Without a CD&A or similar section devoted to describing the executive compensation program, it may be difficult for SRCs to clearly articulate

why shareholders should approve their compensation practices and procedures.

Some SRCs go beyond the scaled-down disclosure framework and include some narrative discussion of their compensation practices and procedures. Given the new Say-on-Pay rules, such elective disclosure may prove especially helpful to SRCs as they seek executive compensation approvals. For those companies that do not include narrative disclosures, some additional disclosure should be added. The disclosure need not be as detailed as the specific CD&A requirements under Regulation S-K Item 402(b). SRCs can use the CD&A rules as guidelines and selectively describe those items that best articulate and provide support for their practices and procedures. To avoid confusion among investors, issuers should carefully consider whether such "CD&A-like" disclosure should be presented under a caption entitled "Compensation Discussion and Analysis."

RELATED DISCLOSURE TIPS

The Say-on-Pay proposal can be presented in the form of a resolution to be adopted by the shareholders or a more general statement to be approved by the shareholders. For issuers that choose the resolution formulation, Rule 14a-21(a) provides the following sample resolution: "RESOLVED, *that the compensation paid to the company's named executive officers, as disclosed pursuant to Item 402 of Regulation*

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S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion, is hereby APPROVED." This form of resolution would necessarily need to be modified for SRCs that do not include a CD&A or who include a CD&A-like section under a different caption. Further, pursuant to the Staff's Compliance and Disclosure Interpretation Question 169.05, companies may replace *"pursuant to Item 402 of Regulation S-K"* with *"pursuant to the compensation disclosure rules of the Securities and Exchange Commission."*

In preparing the annual meeting proxy card, SRCs should note the Staff's guidance on permissible language for describing the Say-on-Pay vote. Language such as *"to approve the company's executive compensation," "advisory approval of the company's executive compensation," "advisory resolution to approve executive compensation,"* and *"advisory vote to approve named executive office compensation"* should be used in lieu of *"to hold an advisory vote on executive compensation"* (Compliance and Disclosure Interpretation Question 169.07).

With the temporary exemption, SRCs had the benefit of learning from the mistakes of larger companies over the past two years regarding reporting the final decision on the frequency of future Say-on-Pay votes. As discussed in our March 30, 2012 advisory, "Say on Pay: Disclosing Decisions on Frequency of Vote," many large companies failed to comply with the Item 5.07 Form 8-K amendment requiring companies to disclose their decision on the frequency of future Say-on-Pay vote within 150 days of the annual meeting at which the Say-on-Frequency vote was presented. Such late 8-K filings could have resulted in Form S-3 eligibility issues. Although the Staff was understanding and accommodating when processing issuers' Form S-3s, SRCs should avoid this position if possible. To avoid a potential missed 8-K filing, SRCs should plan to include their decision in the Item 5.07 Form 8-K reporting the voting results that must be filed within four days of the annual meeting.

This publication is a summary of legal principles. Nothing in this article constitutes legal advice, which can only be obtained as a result of a personal consultation with an attorney. The information published here is believed accurate at the time of publication, but is subject to change and does not purport to be a complete statement of all relevant issues.