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SEC Proposes Rules on Executive Compensation Shareholder Advisory Votes under Dodd-Frank

by **Andrew C. Liazos**

On October 18, 2010, the SEC issued proposed rules regarding the following shareholder advisory votes regarding Dodd-Frank:

- “Say-on-Pay Vote” – voting on whether to approve the compensation of named executive officers as disclosed under federal securities law.
- “Say-on-Frequency Vote” – voting at least once every six year on whether the say-on-pay vote should occur every one, two or three years.
- “Say-on-Parachutes Vote” – voting on whether to approve so-called golden parachute compensation in connection with a change in control transaction. The say-on-parachutes vote is to be accompanied by enhanced disclosure regarding golden parachute compensation.

Say-on-pay votes and say-on-frequency votes will be required for any annual stockholder meeting that occurs on or after January 21, 2011 regardless of whether the SEC has issued final rules regarding these votes before that date. Board members should engage with management now to understand how management will revise executive compensation proxy disclosures for the 2011 proxy season as part of providing these votes to shareholders.

Important features of the proposed rules that are worthy of immediate consideration in preparing for the 2011 proxy season are:

- The proposed rules do not provide any specific language or form of resolution for the say-on-pay vote. However, the say-on-pay vote must cover all disclosed compensation to named executive officers in the CD&A, the tables and related narrative discussion, and not just the overall philosophy, policies and procedures of the compensation committee or its decisions during the most recent fiscal year. This means that shareholders may vote “no” to say-on-pay on the basis of executive compensation results and decisions that have nothing to do with the current directors.
- An issuer is not required to take any action in response to a say-on-pay vote. However, the proposed rules would require an issuer to address in the next CD&A (a) whether, and if so, how, the compensation committee has considered the results of a say-on-pay vote, and (b) how has consideration of a prior say-on-pay vote actually affected compensation policies and

decisions. As a practical matter, imposing this CD&A requirement will put pressure on the compensation committee to carefully consider how to respond to say-on-pay votes.

- The proposed rules provide for shareholders to be given four choices—namely, to vote on whether the say-on-pay vote will occur every one, two or three years, or to abstain from voting on the matter. If adopted in current form, the proposed rules would not allow an issuer to structure the say-on-frequency vote to provide shareholders with fewer choices.
- There is no requirement that an issuer adopt a policy consistent with the results of a say-on-pay vote. However, there's an incentive for an issuer to follow the plurality voting of the say-on-frequency vote. If the issuer commits to holding say-on-pay votes in a manner that's consistent with the plurality of votes, the issuer will be able to exclude a subsequent shareholder proposal seeking more frequent say-on-pay votes on the basis that any such proposal has been "substantially implemented." Whatever policy is adopted on the frequency of the say-on-pay vote must be reported in its next 10-Q (or 10-K if the shareholder meeting is in the last quarter of the fiscal year).
- An issuer will be required to report the voting results for say-on-pay and say-on-frequency on Form 8-K within four business days of the shareholders meeting. We suggest that you check with management as to how an abstention will be counted for purposes of the say-on-pay vote and how it will be reported. Existing voting procedures may effectively treat an abstention as a negative vote, and it remains to be seen whether institutional investment managers who must publicly disclose their executive compensation votes will abstain from voting.
- The proposed rules provide a new standardized form of disclosure for golden parachute compensation to be included in proxy and consent solicitations in connection with a change in control transaction. This form of disclosure is broader than under current rules and, when applicable, requires disclosure of a total amount of golden parachute compensation. Issuers will not be required to provide a say-on-parachutes vote with enhanced golden parachute disclosure for a change in control transaction until the SEC issues final rules.
- The proposed rules do not provide an exemption to the say-on-pay vote and the say-on-frequency vote for small reporting companies even though the SEC has authority under Dodd-Frank to exempt them from these rules.

For more details regarding the proposed rules please see McDermott Will & Emery's [white paper](#).

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