



## A Cumulous Cloud Of Confusion Reigns Over Vote Required For Say-On-Pay Frequency

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In reviewing recent proxy statement filings with the Securities and Exchange Commission, I've noted a great deal of confusion regarding the vote required for approval of the newly mandated advisory resolution on the frequency of shareholder votes on executive compensation. Section 951 of the Dodd-Frank Act requires issuers to include in their proxy statements a *resolution* to determine whether the shareholder advisory vote on executive compensation will occur "every 1, 2, or 3 years". The SEC in its new Rule 14a-4(b)(3) has added the requirement that the proxy card allow a stockholder the option of marking "abstain".

Because the proxy must offer a choice among several alternatives, some companies are stating in their proxy statements that the option that achieves a plurality vote will be determined to be the decision of the shareholders. For example, one company's proxy statement states:

*The choice of frequency that receives the highest number of "FOR" votes will be considered the advisory vote of the stockholders.*

There are at least two significant problems with this approach.

First and foremost, this approach is likely to ignore the vote required for shareholder action imposed by applicable law and the company's charter documents. For example, I checked the bylaws of the company mentioned above. The bylaws specify that shareholder action is taken by affirmative vote of a majority of the shares present and entitled to vote. While one might argue that the resolution is non-binding, the fact that a resolution is only precatory is not a license to ignore applicable voting requirements for determining whether the shareholders have approved the resolution.

Second, the use of a plurality voting rule may cause confusion about the effect of abstentions. As noted above, the SEC's new rule requires that the proxy include an "abstain" option. When shareholder action is required by the affirmative vote of a majority of the shares present and entitled to vote, abstentions are considered (at least under Delaware law) as being "represented" at the meeting and "entitled to vote". See *Licht v. Storage Technology Corp.*, Del. Ch. Ct. No. (March 8, 2005, rev. May 13, 2005). Under a plurality voting rule, however, an abstention doesn't have the effect of a vote against. Thus, companies may not

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properly describe the effect of abstentions when they have a majority of the shares present and entitled to vote rule for determining shareholder action. For example, the issuer mentioned above described the effect of abstentions as follows:

*Abstentions and broker non-votes will not count as votes cast "FOR" or "AGAINST" any frequency choice, and will have no direct effect on the outcome of this proposal."*

Other companies seem to ignore the issue entirely and don't disclose the effect of abstentions with respect to the advisory vote on the frequency of executive compensation.

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