

LEGAL UPDATE

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"SAY ON PAY" SHAREHOLDER PROPOSALS GAIN MOMENTUM IN 2007

As the 2007 proxy season comes to a close, it is clear that executive compensation and the notion of "pay for performance" was one of the most prominent U.S. corporate governance issues in this proxy season. Most notably, shareholder proposals seeking an advisory vote on executive compensation (so-called "say on pay" proposals) appeared in the proxy statements of over sixty U.S. public companies. At 2007 annual shareholder meetings already held, the majority of shareholders of three companies, Blockbuster, Verizon Communications and Motorola, voted in favor of such a proposal, according to data from Institutional Shareholder Services Inc. ("ISS"). Of the proposals that failed to win approval, many garnered the support of 40% or more of shareholders. Additionally, Aflac announced that it would voluntarily institute an advisory vote on compensation beginning in 2009. Judging by the relative success of these "say on pay" shareholder proposals in the 2007 proxy season and, in light of legislation pending in Congress that seeks to require a shareholder vote on executive compensation, U.S. public companies should be prepared for increased shareholder attention on their executive compensation policies.

WHAT IS "SAY ON PAY"?

A "say on pay" proposal, if adopted, would provide the shareholders of a public company the opportunity to cast an advisory vote to ratify the compensation of the company's "named executive officers", or those high-earning executives whose names and salaries are required to be disclosed under federal securities laws in

the company's annual report on Form 10-K or Form 10-KSB or in its Schedule 14A proxy statement. The current proposals generally provide that, even if passed, the shareholder vote remains entirely advisory and the company is under no obligation to alter the compensation of its executives based on the result of the vote. In fact, the proposals to adopt such resolutions to implement a vote on compensation are themselves non-binding, so that even if the majority of shareholders approve the "say on pay" proposals, it is up to the company's board of directors to decide whether or not to institute an advisory vote on executive compensation at the company's next annual meeting.

The "say on pay" proposals contained in 2007 proxy statements were fairly uniform, each being similar to the following sample proposal:

"RESOLVED, that shareholders of the Company urge the Board of Directors to adopt a policy that the Company shareholders be given the opportunity at each annual meeting of shareholders to vote on an advisory resolution, to be proposed by the Company's management, to ratify the compensation of the named executive officers ("NEOs") set forth in the proxy statement's Summary Compensation Table (the "SCT") and the accompanying narrative disclosure of material factors provided to understand the SCT (but not the Compensation Discussion and Analysis). The proposal submitted to shareholders should make clear that the vote is non-binding and would not affect any compensation paid or awarded to any NEO."

Proponents of “say on pay” proposals (i.e. those shareholders seeking to include the proposal in the proxy statement) included pension funds, such as the New York City Employees Retirement System, organized labor, such as the AFL-CIO and the American Federation of State, County and Municipal Employees, as well as religious organizations and individuals.

ARGUMENTS CITED FOR AND AGAINST “SAY ON PAY” PROPOSALS

Generally speaking, the arguments made by the shareholder proponent for the “say on pay” proposals and by the board of directors against the proposal, as set forth in the relevant proxy statement, were very similar to arguments made by most other shareholder proponents and boards of directors. Proposing shareholders claimed that the existing U.S. corporate governance standards, including the current rules of the Securities and Exchange Commission, do not provide shareholders adequate means for input to boards of directors regarding executive compensation. Additionally, shareholders cited the corporate governance practices of countries like the United Kingdom, Sweden, Australia and the Netherlands, where investors in public companies already possess the right to cast an advisory vote on executive compensation.

Boards of directors, on the other hand, argued that the proposals are not in the best interest of the shareholders. These boards contended that the proposed “for” or “against” vote to ratify compensation is not an effective means of communicating the shareholders’ views of the merits, limitations or preferred enhancements of the company’s executive compensation. These boards also stated that efficient means of communication with their respective directors is already accessible to shareholders through written requests and attendance at annual meetings.

2007 MEETING RESULTS

In the 2007 proxy season, shareholders of sixty U.S. public companies (including very large companies such as Morgan Stanley, Blockbuster, Coca-Cola, Merrill Lynch, Verizon Communications, Merck, United Technologies, Boeing and Exxon) successfully introduced “say on pay” shareholder proposals. Thus far, shareholders of just three companies, Blockbuster, Verizon Communications and Motorola, voted in favor of the proposal, according to ISS. Even though the proposals were passed by the shareholders, since the resolutions are non-binding, it is up to the respective boards to actually implement the shareholder vote to ratify executive compensation at the next annual meeting. Although the large majority of “say on pay” proposals did not receive enough shareholder support to pass this season, the results were close at several annual meetings. For example, according to ISS, 47% percent of shareholders supported the proposal at The Bank of New York’s annual meeting, as did 49% of shareholders of Merck Pharmaceuticals, 48.5% of shareholders of Occidental Petroleum and 46% of shareholders of Apple.

PROPOSED LEGISLATION

Despite the failure of a large majority of “say on pay” proposals this proxy season, and the fact that boards are not required to implement the vote in the small number of proposals that passed, U.S. public companies may soon be required by federal law to enact advisory shareholder votes to ratify executive compensation. Earlier this year, the U.S. House of Representatives recently passed H.R. 1257, the Shareholder Vote on Executive Compensation Act, introduced by Representative Barney Frank of Massachusetts. This bill seeks to amend the Securities Exchange Act of 1934, as amended, to grant shareholders an advisory vote on the compensation of certain named executives, including any severance agreements that are

reached while a company is considering a takeover offer or merger. To become a law, the bill must be approved by the Senate and signed by the President. Thus far, the bill has advanced to the Senate, having been introduced by Senator Barack Obama of Illinois as Senate Bill 1811, in almost identical form as the House bill and has been referred to the Senate Committee on Banking, Housing, and Urban Affairs. If enacted, the shareholder votes would be implemented, by law, at shareholder meetings after January 1, 2009. Members of President Bush's administration have expressed opposition to the proposed legislation, stating that Congress should not mandate the approval process for executive compensation, although the President has not publicly stated that he would veto the act if it passed

CONCLUSION

The relative success of "say on pay" proposals in the 2007 proxy season, coupled with the possibility of enacted legislation requiring a shareholder vote, provide strong indications that a larger number of U.S. public companies may face "say on pay" proposals during the 2008 proxy season. Companies should consider this possibility when setting their executive compensation policies.

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The foregoing is merely a discussion of "say on pay" proposals and is not intended to provide legal advice. If you would like to learn more about this topic or about how Pryor Cashman LLP can serve your legal needs, please contact us.

ABOUT THE AUTHORS



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Ed has represented clients at every stage of development, from start-up ventures to publicly traded corporations, engaged in a wide range of industries, such as pharmaceutical, media and entertainment, software development, healthcare services and apparel, among many others.

Prior to joining Pryor Cashman several years ago, Ed practiced law with a New Jersey firm where, in addition to his current areas of focus, he represented corporate borrowers and financial institutions in bank lending transactions and counseled clients in technology-related transactions.

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Melissa is a 2006 graduate of St. John's University School of Law, where she was a St. Thomas More Scholar and Frontline Editor for the Journal of Legal Commentary. While in law school, Melissa was a judicial intern for Judge Denise Cote in the United States District Court for the Southern District of New York.

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