"Say on Pay" and Other Issues for the Upcoming Proxy Season

Exclusive Interview with
David M. Lynn, Morrison & Foerster LLP
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Transcript by

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What are some of the issues that public companies have to pay particularly attention to for the upcoming proxy season?

This year the proxy season is going to be very interesting for public companies because, as in the last few years, we're going to have a lot of shareholder activism and there's a lot of attention focused on executive compensation and corporate governance.

And now we have the Dodd-Frank Act, which was enacted over the summer and which will require all public companies to submit to their shareholders an advisory vote on executive compensation, as well as a vote on how often they should vote on their executive compensation. And this is going to be something new for many companies. It's been tried out, sort of lab tested for companies that received TARP assistance. But for the first time, it's going to be required for all public companies this year.

So specifically, what does the FCC propose in terms of the rules regarding Say-on-Pay?

This new advisory vote on executive compensation, which people call Say-on Pay, is effective beginning for meetings occurring on or after January 21st of 2011, and the SEC has now proposed some rules that will essentially implement the provision of Dodd-Frank that talk about Say-on-Pay. Now even if those rules don't go effective, companies still have to seek this shareholder vote. And effectively what will happen is companies will have new proposals in the proxy statements and they'll have to really focus on their disclosures elsewhere about executive compensation because this new vote about pay will focus institutional investors, retail investors, and the public more on the compensation disclosures that companies have.

So how do you advise companies to best prepare for Say-on-Pay?

Companies need to really think closely about their strategy and preparing for the Say-on-Pay vote. The Say-on-Pay concept came to us from abroad. In the United Kingdom, it was introduced in 2002. And the idea behind it was really to encourage shareholder engagement over executive compensation issues. The fact that this vote was going to happen was enough to prompt companies go to out and talk to their institutional investors and find out what concerns they might have with pay programs.

This same level of engagement is expected to happen now in the United States as a result of the imposition of a Say-on-Pay requirement. And that's one of the first things companies need to do is identify their largest institutional investors, figure out what sort of concerns and policies they might have about compensation programs, and go out and start talking to them. If they're willing to engage in a discussion, discuss with them things about the company's program that may or may not result in support for the Say-on-Pay resolution.

In addition to that, companies are going to have to focus on their disclosure because before, company had largely been thinking about writing their disclosures for the SEC's benefit or for the public's benefit, but really need to focus on convincing shareholders that they should support this and cast an affirmative vote for the executive compensation program.

What are the requirements as far as how often the Say-on-Pay vote should occur?

One of the things the Dodd-Frank Act requires is that not only do you have to get the Say-on-Pay vote, which has to happen once every three years, but you also have to seek a vote once every six years on how often you're going to ask shareholders to vote on pay going forward. And what the SEC has proposed is that the proposal would be cast essentially like a poll. You would ask the shareholders, "Do you want to vote on the Say-on-Pay resolution every one year, every two years, or every three years?"

So what are the considerations in terms of the recommended frequency of Say-on-Pay vote?

The SEC hasn't prescribed exactly how you should write that resolution or whether the company needs to make a recommendation, but by and large, I have been advising the company should make a recommendation as to which frequency they should use. And a lot of factors go into deciding what's the best frequency. Some companies have very long-term compensation program that work on two- or three-year performance cycles. And for them, it might make more sense to have a vote every three years.

Contrast to that, a lot of institutional investors think that shareholders should have voice every year, and as such, you should have a Say-on-Pay vote every year so that the focus can be on the executive compensation disclosure and the pay decisions that are made by the compensation committee.

Are there specific provisions in the Dodd-Frank Act regarding golden parachutes?

Another aspect of the Dodd-Frank Act was to require a separate vote on golden parachute arrangements. And golden parachute arrangements are essentially arrangements that are triggered by a merger, a disposition, or other major transaction. And what the Dodd-Frank Act said is when that merger is put up to a vote of shareholders, the shareholders also should give an advisory vote on the golden parachute compensation itself.

Now they also said that you could put that golden parachute compensation up for a vote under the regular Say-on-Pay vote that happens at the annual meeting, and thereby avoid having to put it up later at the time of the merger or other extraordinary transaction.

Would you forsee companies putting golden parachutes to vote at their annual meetings as well?

It seems unlikely that people will want to put the golden parachute votes up for a vote on an annual basis and really just wait to see what happens if there's a merger or other transaction. But this is something we'll have to see play out over time.

In any event, what it will do is focus lots of attention on benefits that are triggered by mergers, some change in control, and that will probably have a lasting effect on what boards make in terms of decisions about putting those types of change-of-control provisions in place going forward.

How can companies generate shareholder support for the Say-on-Pay vote?

In terms of generating shareholder support for the Say-on-Pay vote, I think the keys are engagement with the shareholders, actually talking to them, understanding what they want. And that may not just be with the institutional shareholders. It may be going out and taking a poll of what the retail shareholders are very interested in. It may also be going out and trying to figure out "Are there elements of my pay program that when looked at from the outside may be viewed adversely by proxy advisory services such as ISS, as well as shareholders? And are there ways I can make adjustments now that will lead to support for the Say-on-Pay going forward?"

And another major consideration is really focusing on the disclosure itself and trying to streamline the disclosure, make it a lot less hard to get through in the proxy statement, which has really been a problem developing over the last few years because people keep adding more and more information. And so people put things like executive summaries in their compensation disclosure to try and really emphasize and ask for support of a Say-on-Pay resolution.

How does a company interpret a Say-on pay or a Say-on-Frequency vote?

In terms of trying to interpret the advisory vote on executive compensation that will happen at the company's annual meeting, and then the vote in terms of how often they should vote on that advisory vote on compensation, it's a bit of a blunt instrument, and that's one of the problems I think with the Say-on-Pay vote that people struggle with. It's not a line-item vote on each executive officer's compensation, nor is it really specific to any elements of compensation as well, whether it be equity awards or cash awards or the like.

So when people get a Say-on-Pay vote that may be adverse or not strong support, they're going to really have to figure out what was it that caused this problem. And that's gonna have to happen through the engagement process. It's gonna have to happen through looking through reports that institutional investor advisory services have put out. And it's gonna have to be out there on the road talking to people and trying to understand what may have caused concerns with the company's pay.

What about in regard to the issue of frequency?

In terms of the frequency of the advisory vote on compensation, I think that will be something people will have to work out because it really is a poll. Because there are three choices, it doesn't mean one will get the clear majority. And are people struggling with what would be the best way to interpret the result, whether to apply sort of a plurality standard where whatever carries the most votes would indicate to the company what is the appropriate frequency. And I think this will a learning process for us all this proxy season to try and work out these issues.

What impact do you anticipate these votes having on director elections?

One question in terms of how these votes will impact director elections is, I think, what will the proxy advisory services like ISS do. And what they have done in the past proxy season is if a company has a Say-on-Pay vote on its ballot, that's the target ISS will shoot at. And if ISS has problems with the company's compensation programs, it will recommend a vote against the Say-on-Pay. And then if that problem isn't remedied by the next proxy season, ISS will shift the focus to members of the board that serve on the compensation committee, and seek to withhold votes for those directors as a signal that, "We're still unhappy with the Say-on Pay vote."

And so as result of all this, I think in some ways, Say-on-Pay will take the pressure off of compensation committee elections because there'll be some other mechanism in which shareholders can express concern or displeasure with the executive compensation programs.

Are there any other challenges you think companies will face during the upcoming proxy season?"

I think each proxy season seems to be getting more and more complicated in terms of the new requirements of what the SEC expects and what shareholders expect. And I think one of the big focuses this year is, again, gonna be revisiting disclosures that are made in proxy statements so that they're more accessible, and we'll a lot of people who – not necessarily drawing on a blank slate, but really coming back and thinking about what's the best way to present this and what's the best way to emphasize the points that we're going to try to make to support our pay program.

In addition to compensation, people are very much focused on corporate governance and whether a company has implemented majority voting or whether it still has a classified board, or whether the chairman and CEO are and separate positions or the same individual serving as both. And those situations continue to be hot-button issues for shareholders that affect the outcome of votes for many different kinds of proposals.

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