DAY PITNEY LLP

alert

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CORPORATE EXECUTIVE ESSENTIALS

Update on "Say on Pay"

On July 15, 2010, the U.S. Senate approved the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Dodd-Frank Act represents one of the most significant financial reforms proposed in recent decades and presents numerous corporate governance and securities law issues that will require the attention of corporate executives. It is expected that the legislation will be signed into law by the President in the coming week. In light of its anticipated enactment, corporate executives will need to consider issues that are certain to arise under their companies' current or future executive compensation programs.

The "Say on Pay" provisions, contained in Section 951 of the Dodd-Frank Act (which inserts new Section 14A provisions into the Securities Exchange Act of 1934), require that (i) beginning with the first annual meeting of shareholders occurring six months after the Dodd-Frank Act is signed into law, and (ii) not less frequently than once every three years, a company's proxy statement for an annual meeting of shareholders now include a separate resolution, subject to a nonbinding shareholder vote, to approve executive compensation as disclosed pursuant to Item 402 of Regulation S-K.

The Dodd-Frank Act also requires that (i) beginning with the first annual meeting of shareholders occurring six months after the Dodd-Frank Act is signed into law, and (ii) not less frequently than once every six years, a company's proxy statement for an annual meeting of shareholders additionally include a separate resolution subject to a nonbinding shareholder vote to determine whether "Say on Pay" votes will occur *annually*, *biennially* or *triennially*.

The foregoing shareholder votes are nonbinding on the issuer or its board of directors and will not overrule a decision by the issuer or its board of directors, create or imply any change or addition to the fiduciary duties of the issuer or its board of directors, or restrict the ability of shareholders to make other proposals related to executive compensation.

Additionally, Section 957 of the Dodd-Frank Act prohibits brokers from voting on any executive compensation matters, which would presumably

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include the “Say on Pay” provisions, without a specific instruction from the beneficial owner of the security.

The Dodd-Frank Act does not expressly require the SEC to adopt rules that implement the “Say on Pay” provisions, but the SEC will likely provide clarification as to the following items, which are not clearly delineated in the legislation:

- **Filing of a Preliminary Proxy Statement.** Unless the SEC adopts guidance or a rule to the contrary, a “Say on Pay” resolution could potentially necessitate the filing of a *preliminary* proxy statement pursuant to Rule 14a-6 of the Securities Exchange Act of 1934. However, the Exchange Act does not require the filing of preliminary proxy statements in connection with a “Say on Pay” vote by companies that are TARP recipients subject to Section 111(e)(1) of the Emergency Economic Stabilization Act of 2008. Consequently, it seems likely that the SEC will also exempt companies from filing a preliminary proxy statement in connection with a “Say on Pay” vote required by the Dodd-Frank Act.

- **Contents of Resolution.** The Dodd-Frank Act does not expressly describe the contents of the required resolutions. The reference to Item 402 of Regulation S-K implies that the required resolution ought to seek shareholder approval of the executive compensation of a company’s “named executive officers” (as defined in Item 402(a)(3) of Regulation S-K). Although there is no specific guidance as to what information will require approval, it may be presumed that the Dodd-Frank Act will require shareholder approval of the executive compensation disclosure contained in the Compensation Discussion and Analysis (CD&A), the executive compensation tables, and any related disclosures in the company’s proxy statement.

- **Frequency of “Say on Pay.”** Although the Dodd-Frank Act imposes a requirement to determine the frequency of the “Say on Pay” vote at least once every six years, it remains unclear whether shareholders are to be presented with a choice regarding the frequency of such resolutions and whether such choice will be between two alternatives (i.e., annually versus biennially or triennially) or among all three alternatives. It is also important to note that there are no apparent restrictions in presenting the vote more frequently than once every six years. Consequently, it is conceivable that shareholders could approve a biennial or triennial frequency of vote but be presented each year with a shareholder proposal to hold a “Say on Pay” vote annually. It is likely that there will be additional guidance in the months that follow.

Although the “Say on Pay” provisions apply to all companies that are required to comply with the SEC’s proxy rules, the Dodd-Frank Act’s inclusion of a new Section 14A(e) to the Exchange Act affords the SEC authority to grant exemptions to the extent it determines that the requirements would disproportionately burden a small issuer. It remains unclear how this exemption will be applied by the SEC, if at all.

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The “Say on Pay” requirements will become effective and applicable to the proxy statement for the first annual meeting of shareholders occurring six months after the provisions are signed into law. This would mean that if the Dodd-Frank Act is signed by the President in the coming week, as anticipated, the requirement to include a “Say on Pay” resolution would apply to annual meetings occurring after mid-January 2011.

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