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The SEC has released guidance for implementation of the executive compensation provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, with significant requirements for shareholder advisory votes and "say on pay" provisions.

Mandatory Shareholder Approval of Executive Compensation: SEC Releases Final Rules on "Say on Pay"

By Steven Friedman and Philip Berkowitz

The recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") mandates, for publicly traded companies, shareholder advisory votes on compensation packages provided to top executives and on "golden parachute" packages payable in connection with corporate transactions. This new law, which stems directly from the recent financial crisis and the perception that the crisis was fueled, at least in part, by compensation that purportedly rewarded excessive risk taking, constitutes the broadest, government-mandated requirements for executive compensation in many years.

The Securities and Exchange Commission (SEC) has now released guidance necessary to implement this and other executive compensation provisions of Dodd-Frank. We note below the most salient features of the SEC guidance.

Say on Pay Provisions

"Say on Pay" requires public companies to provide for a non-binding shareholder advisory vote on the executive compensation packages offered to those who are "named executive officers" on its proxy. The required vote is an "up" or "down" vote on the compensation payable to all of a company's named executive officers as disclosed under Item 402 of Regulation S-K. This advisory vote must occur at least once every three years, beginning with the first annual shareholders' meeting after January 21, 2011.

The final rules clarify that a company must explain the effect of this vote to the shareholders on the proxy statement. It is expected that some companies will go beyond the strict requirements of Dodd-Frank and provide that the shareholder vote will be binding on the company. In this case, the company must disclose to the shareholders the binding nature of the vote. After the year of the initial vote, a company must also disclose how the results of the votes were used, if at all, in setting compensation policy.

The newly issued rules require no specific language or form of resolution to be used for these purposes. However, the SEC mandates that the vote must relate to *all* of the compensation required to be disclosed. If they choose, companies may also seek votes on specific compensation matters and may indeed provide for multiple advisory shareholder votes.

Frequency of Votes

Dodd-Frank requires that, at least once every six years, shareholders be permitted to cast a new advisory vote on how frequently they wish to cast a "Say on Pay" vote. The final rules also permit shareholders either to abstain from voting or to choose a frequency period of every one, two, or three years. This shareholder vote on frequency of "Say on Pay" must be presented at the first shareholders' meeting taking place on or after January 21, 2011. The rules mandate that companies disclose in their proxy statement that they are holding a shareholder vote on frequency of "Say on Pay" votes. Companies must also explain the effect of the votes (*i.e.*, if the vote is purely advisory and nonbinding, or if it will have any binding effect). The proxy also must explain how often there will be a "Say on Pay" vote and when the next such vote will be conducted. If the company permits its shareholders to abstain from making a recommendation on the proxy card and informs the shareholders how uninstructed cards will be voted, then the "abstained" shares may be voted in accord with management recommendations.

If a company adopts the majority shareholder recommendations regarding frequency of "Say on Pay" votes, then other shareholder proposals for "Say on Pay" or frequency of "Say on Pay" votes may be excluded from consideration at a shareholders' meeting.

A company must disclose its decision on how often it will conduct "Say on Pay" votes on Form 8-K. The Form 8-K must also disclose the results of the shareholder vote on frequency of the "Say on Pay" votes.

Golden Parachute Compensation

Companies must include a separate shareholder "Say on Pay" vote for compensation in any proxy issued in connection with a corporate transaction, where the named executive officers will receive special compensation in connection with the pending transaction (that is, parachute compensation). All companies involved in the transaction must make this disclosure. The parties must disclose all cash payments, equity grants and awards related to equity-related plans, qualified and nonqualified retirement plans, deferred compensation, and all other transaction-related compensation.

The company need not provide a separate vote on parachute compensation if it has already disclosed this compensation in a prior "Say on Pay" vote. If prior compensation arrangements were previously disclosed for a vote by shareholders, but the arrangements were subsequently modified, a new vote will be required on the modified parachute compensation.

If the disclosure tables have been modified solely in connection with a market value update of company securities, then no vote is needed. However, any modifications that result in a Section 280G tax gross up will require a new vote. Moreover, if the company names new executive officers and, as a result, makes compensation changes, then new shareholder voting also will be required. These new votes must be contained in proxy statements seeking shareholder approval of a corporate transaction filed on or after April 25, 2011. Such arrangements that are already in effect would, of course, need to be subject to a "Say on Pay" vote by shareholders (as described generally, above), whether or not there is a specific corporate transaction being contemplated.

Littler will continue to monitor events in this fast-changing area.

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