

# Client Alert

February 4, 2011

## SEC Finalizes Say on Pay Rules

### Early Filer Results and Observations

This Client Alert outlines modifications made by the SEC in the Final Rules<sup>1</sup> for conducting shareholder advisory votes on Say on Pay (SOP), Say on Frequency (SOF) and Say on Golden Parachutes (SGP), collectively referred to as the SOP Advisory Votes. Adopted on January 25, 2011, the Final Rules make only limited changes to the Proposed Rules issued on October 18, 2010<sup>2</sup>. We also provide a look at the early filer advisory vote recommendations and shareholder results from the first filers.

At the end of this Client Alert is the most recent rulemaking schedule for other compensation-related requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Among the more significant changes: the SEC's *proposed* guidance for disclosure of clawbacks, pay-for-performance, internal equity and hedging could be issued as late as December 2011, potentially pushing effective dates for these provisions beyond the 2012 proxy season.

#### I. Significant Modifications and Clarifications From Proposed Rules

- **Effectiveness:** The Final Rules confirm that SOP and SOF are required for proxies related to a company's first annual meeting on or after January 21, 2011. The SGP vote applies to any initial transaction filing on or after April 25, 2011.
  - **Two-Year Delay for Smaller Reporting Companies:** Smaller reporting companies (historically defined by the SEC as those with a public float of under \$75 million) are exempt from SOP and SOF (but *not* the SGP requirement) until meetings on or after January 21, 2013.

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<sup>1</sup> The Release can be found at: <http://sec.gov/rules/final/2011/33-9178.pdf>

<sup>2</sup> For a detailed summary of the Proposed Rules, see our previous Client Alert dated October 25, 2010 at [http://pearlmeier.com/Pearl/media/PearlMeyer/PDF/PMP-CA-SOPAdvisoryVotes-10-25-10\\_1.pdf](http://pearlmeier.com/Pearl/media/PearlMeyer/PDF/PMP-CA-SOPAdvisoryVotes-10-25-10_1.pdf)

- **Form of Resolution:** The SEC did not specify language for either SOP or SOF, but in response to various comments, the Final Rules provided sample language for a SOP resolution, as follows:

*“RESOLVED, that the compensation paid to the company’s named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion, is hereby APPROVED.”*

- **Exclusion of Future SOP and SOF Proposals For Adopting Majority SOF Vote:** A company that adopts the most recent SOF approved by a *majority* of shareholders (as opposed to the plurality standard in the Proposed Rules) can exclude any subsequent shareholder SOP or SOF proposals until the next required SOF vote.

***PM&P Observation:** The SEC has clearly raised the bar for this important exemption. However, SOP voting results to date indicate that in almost all cases, a clear majority has favored one option (e.g., annual or triennial), due to abstentions not being counted in the majority calculation, as well as minimal votes being cast in favor of biennial SOF.*

- **Annual Meetings Only; No Transitional Relief for IPOs:** The Final Rules clarify that SOP and SOF are required only for annual meetings or special meetings in which proxies are solicited for Director elections. In addition, the Final Rules clarify that newly public companies are *not* exempt from this rule.

#### Say on Pay

- **Disclosure of Impact of Most Recent SOP in CD&A:** The Final Rules confirm that the CD&A *must* explain whether and, if so, to what extent the company took the SOP shareholder vote into account in determining compensation. The SEC clarified that this requirement applies only to the *most recent* SOP vote; however, in cases where older SOP votes were material to decision-making in the current year, these too should be discussed.

#### Say on Frequency

- **Disclosure of SOF Adopted by Company:** Companies must report their decisions regarding the SOF vote in a Form 8-K no later than 150 calendar days after the meeting date and no later than 60 calendar days before the submission deadline for shareholder proposals for the subsequent annual meeting. For most companies, this will delay the implementation deadline for required SOF decision-making and reporting until the Fall of 2011.

***PM&P Observation:** The SEC had originally proposed requiring disclosure of SOF in the periodic filing for the same calendar quarter as the annual meeting, which would have left little time for discussion of the voting results at the Committee or Board level or with shareholders.*

- **New Requirement for SOF Disclosure in Proxy:** Effective for 2012, annual proxies must include the SOF adopted by the company and the date of the next SOP vote.
- **Limited Exception for Counting Uninstructed Proxy Cards:** The Final Rules allow counting of uninstructed proxies in favor of management’s recommended SOF if three

requirements are met: (1) a recommendation for SOF is provided in the proxy statement; (2) the proxy card includes an abstention option; and (3) the proxy card includes a statement, in bold, indicating how the company will vote uninstructed proxies.

### Say on Golden Parachutes

- **Scope:** The SGP requires companies to provide a separate shareholder advisory vote in proxy statements for meetings at which shareholders are asked to approve an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all of the issuer's assets. The Final Rules clarify that the SGP vote is not required in the case of bidders in third-party tender offers.
- **Exception Where SGP Vote Is Covered by Annual SOP Vote:** If an annual proxy provides SGP vote disclosure as well as an SOP vote, any subsequent M&A transaction proxy can exclude the SGP vote *as long as no changes or modifications* were made to those arrangements as disclosed in the annual proxy. If changes were made, the subsequent SGP vote in the merger proxy can be limited to those changes only, as long as a separate table is provided with the modifications. The SEC provided some examples of whether a change is considered sufficiently material to warrant a subsequent vote:
  - A *reduction* made in the total value of a golden parachute arrangement does *not* require a subsequent shareholder vote;
  - Changes due solely to fluctuations in stock price do *not* require subsequent vote, *unless* the price change results a Section 280G gross-up payment that was not previously payable; and
  - A subsequent shareholder vote *is* required for arrangements for new NEOs who are subject to golden parachutes identical to those already voted upon, as well as for routine increases for salaries and new equity grants.

**PM&P Observation:** *In our previous Client Alert, we anticipated that given the likelihood of changes being made to arrangements between the time of the annual proxy filing and a merger proxy, few companies would choose to voluntarily include SGP in their annual SOP. Indeed, we have not seen any annual proxies among early filers that included the optional SGP.*

- **Golden Parachute Calculation:** If a company puts SGP in its annual proxy, the compensation disclosed is based on the closing price of the company's stock on the last business day of its last completed fiscal year. With respect to transactional filings, the Proposed Rules had suggested using the stock price on the "latest practical date," but the SEC is now requiring the actual deal price. If the deal price is not known, companies should use the average closing price over the first five business days following public announcement of the transaction.

## II. A Look at Early Filer Recommendations and Voting Results

### Say on Pay Results

All but two of the reporting companies with annual meetings in January received a high majority vote in favor of SOP: Jacobs Engineering Group Inc. failed to obtain majority support, while Monsanto Inc. received only 66% support.

According to Jacobs' Form 8-K filing, 53.7% (48.75 million shares) were opposed, 44.8% (40.67 million shares) voted in favor, and 1.4% abstained (1.31 million shares). Significantly, 16.24 million shares were broker non-votes that could not be counted, but might have affected the outcome. The opposition appears related to concerns over pay-for-performance. In the past year, the company's total CEO compensation rose 33.7 percent, although its most recent one- and three-year total shareholder returns were below the median TSR for its 4-digit GICS peer group. Not surprisingly, ISS recommended against Jacobs' SOP based on the ISS Pay-for-Performance Evaluation. This negative recommendation was issued by ISS despite an absence of any other identified poor pay practices.

In the case of Monsanto, ISS also seems to have recommended against the SOP based solely on its Pay-for-Performance Evaluation. Similar to its report on Jacobs, ISS did not factor in Monsanto's otherwise acceptable pay program and the absence of any identified poor pay practices.

***PM&P Observation:*** *Monsanto, which has very high institutional ownership, apparently made a strong effort to reach out to shareholders to obtain a favorable vote despite a negative ISS recommendation.*

***PM&P Observation:*** *In making SOP recommendations, ISS appears to be strictly following its formulaic pay-for-performance standard. This is a sobering – but not surprising – result, given that ISS had clearly communicated this in its recent U.S. Policy Update. Since neither Jacobs nor Monsanto were called out for problematic pay practices, it suggests that other companies with otherwise strong pay-for-performance programs could receive a negative SOP recommendation solely on the basis of an increase in CEO total compensation when one- and three-year TSR is below median TSR of the 4-digit GICS peer group. Paradoxically, in many of these cases, an increase in pay may be tied to performance-based incentives that may never be earned or paid out.*

### Say on Frequency Results

In tracking management recommendations, as of January 31 approximately 30% recommended annual; 6% recommended biennial; 57% recommended triennial; and 6% did not make a recommendation to shareholders.

Among the companies reporting results in January, roughly two-thirds received majority shareholder support for management's SOF recommendation. Where this was not the case, a majority of shareholders had voted for annual SOF, while the company recommended a triennial vote. At Monsanto, where management recommended triennial SOF, 62% of shareholders voted for an annual vote, 1.4% for biennial, and 36% for triennial. Monsanto has already announced it will adopt the majority recommendation for annual SOF.

## Say on Golden Parachute in Annual Proxy

As previously noted, not surprisingly, none of the proxies filed through January included the optional SGP vote that would preempt later disclosure in an actual merger filing.

### III. Delayed Implementation Schedule

The SEC has once again delayed issuing guidance for the implementation of other Dodd-Frank provisions, as detailed in the following chart. Specifically, proposed guidance for disclosure of pay-for-performance, the ratio of CEO pay to other employees, hedging and clawbacks – originally scheduled to be released between April and July 2011 – will instead not be available until between August and December of 2011. If proposed guidance is delayed until as late as December, those Dodd-Frank requirements are unlikely to be effective for the 2012 proxy season.

Provision	Effective Dates in DFA	Status or Further Action Scheduled
Say on Pay and Say on Frequency	Proxy statements for meetings on or after 1/21/2011	SEC issued Final Rules 1/25/2011
Say on Golden Parachute	Effective on or after 4/25/2011	SEC issued Final Rules 1/25/2011
Financial Institution Excessive Compensation Rules	Rules to be issued by 4/21/2011	Proposed Rules Issued by Joint Regulators Feb., 2011 Final Rules scheduled for Apr. – July, 2011
Compensation Committee & Advisor Independence; Committee's Oversight Authority	Effective by 7/16/2011	SEC to issue Proposed Rules Jan. – Mar., 2011 SEC to issue Final Rules Apr. – July, 2011
Disclosure of Compensation Consultant Conflict of Interest	Proxy statements for meetings occurring on or after 7/21/2011	SEC to issue Proposed Rules Jan. – Mar., 2011 SEC to issue Final Rules Apr. – July, 2011
Clawback Policy	None stated	SEC to issue Proposed Rules Aug.– Dec., 2011
Pay-for-Performance Disclosure	None stated	SEC to issue Proposed Rules Aug.– Dec., 2011
Internal Equity Ratio Disclosure	None stated	SEC to issue Proposed Rules Aug.– Dec., 2011
Disclosure of Hedging	None stated	SEC to issue Proposed Rules Aug.– Dec., 2011
Disclosure of COB/CEO Roles	None stated, but it is so similar to 2010 rule that most companies have complied in the 2011 proxy	SEC has not committed to dates for guidance
Proxy Access	SEC issued final proxy rules August 25, 2010; effective 60- days from publication in Federal Register, but delayed implementation pending Court of Appeals review	Court of Appeals review – expedited, but no firm dates set
Broker Non-Vote on Executive Compensation	Effective 7/21/10	SEC to issue clarifying Proposed Rules Apr. – July, 2011

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