

'Say on Pay' Legislation Gains Momentum

By Marjorie M. Glover, Chadbourne & Parke LLP



Marjorie Glover

In the wake of this unprecedented financial crisis, there has been a public outcry for greater accountability for executive compensation. This year, shareholders from over 100 companies requested the right to vote on compensation paid to the company's executives. These votes, known as "say on pay" votes, have gained further momentum as the year has progressed. When the federal government passed its financial stimulus package earlier this year, it mandated that recipients of the troubled asset relief funds provide "say on pay" votes to shareholders. Since then, a number of bills have been introduced into Congress that would require "say on pay" votes for all public companies.

The leading "say on pay" proposal, the Corporate and Financial Institution Compensation Fairness Act of 2009 (HR 3269), was introduced by Rep. Barney Frank and passed by the House of Representatives in late July of this year. HR 3269 is based upon the Treasury Department's "say on pay" proposal that was introduced earlier in July. The Treasury Department's proposal largely mirrors "say on pay" rules that were passed in the United Kingdom in 2002. The Senate is expected to consider HR 3269 this month and some form of "say on pay" legislation is expected to be passed this fall.

What HR 3269 Would Require

The House bill, HR 3269, would require that shareholders of public companies have an annual advisory nonbinding vote on executive compensation. HR 3269 would apply only to a public company's named executive officers, which under the SEC's rules generally consist of the CEO, the CFO and the three other most highly paid executive officers. The proposal would require that shareholders be provided a separate vote to

approve the NEO compensation disclosed in the detailed information on NEO compensation included in the company's proxy.

HR 3269 would also require that shareholders have a separate advisory nonbinding vote on golden parachutes in connection with shareholders approval of certain mergers, acquisitions and other corporate transactions.

HR 3269 also calls for independent board of directors' compensation committees and independent compensation consultants, legal advisors and other consultants. Compensation committees would have the right to obtain advice from independent compensation consultants. Companies would be required to disclose whether their compensation committees obtained advice from independent compensation consultants or, if they did not, whether it was not in the shareholders' interests to obtain such advice.

In addition, HR 3269 would require larger institutional investors to disclose how they voted on executive compensation matters on an annual basis.

HR 3269 would impose additional restrictions on financial institutions, including requiring disclosure of incentive pay arrangements to appropriate government regulators and prohibitions on incentive pay arrangements that government regulators deem risky to the covered financial institution or the economy. These additional restrictions would not apply to financial institutions with assets of less than \$1 billion.

If enacted, the "say on pay" provisions of HR 3269 would not generally¹ take effect until the first annual meeting that is more than six months after the SEC issues final regulations under the new law. Because the SEC may offer a 60-day comment period before finalizing regulations, the new law may not take effect until after May of 2010. Many (if not most) public companies hold their annual meetings in the spring. As a result, the "say on pay" legislation would not impact most public companies until the 2011 proxy season.

Companies that failed to comply with the "say on pay" proposals would face stock exchange delisting and possibly other SEC sanctions.

Other 'Say On Pay' Legislation

Other "say on pay" proposals have also been introduced into Congress. The Shareholder Bill of Rights Act of 2009, introduced by Sen. Charles Schumer, D-N.Y., in May of this year, would also require an annual nonbinding shareholder vote on executive compensation and a special shareholder vote on golden parachute arrangements in connection with certain corporate transactions. The Senate bill would also require greater shareholder input in board elections and stricter corporate governance standards. In addition, a separate House bill also introduced in July would require an annual nonbinding shareholder vote on executive pay.

In addition to "say on pay" proposals, more restrictive limits on executive pay have been proposed in various House and Senate bills, including specific caps on pay, "claw backs" of unearned incentive pay, prohibitions on severance paid for non-performance, disclosure of pay disparity between the lowest and highest paid employees, director election reform and director independence.

How 'Say On Pay' Legislation Will Impact Companies and Executives

It is generally expected that HR 3269 or a similar bill will be passed in some form this fall. Given other legislative priorities such as health care reform, such legislation may be delayed until later in the fall. If "say on pay" legislation is passed this fall, it is not likely that it will become effective until the 2011 proxy season. This will give public companies much needed time to review compensation disclosure and, in some cases, compensation arrangements.

If "say on pay" legislation is passed in its current form, it is expected that the "say on pay" votes will be nonbinding. Some opponents of the legislation believe "say on pay" legislation does not go far enough and instead call for binding votes and

outright limits on executive pay. Many critics believe nonbinding annual votes are reactive rather than proactive, since as a practical matter the votes would relate to compensation arrangements that are already in place. Other opponents believe the legislation goes too far and imposes unnecessary government regulation that will interfere with companies conducting their businesses and unfairly penalize companies that have exercised sound business practices. Some opponents would call for less frequent shareholder votes on pay (such as every three to five years rather than every year) or exemptions for companies that have obtained a two-thirds majority vote in prior years.

Proponents of "say on pay" legislation believe the legislation would provide a company's owners the information necessary to determine whether their senior executives are compensated properly and in proportion to the value they add to the company. Proponents note that the current proposals are relatively modest in that they do not impose specific limits on the amount or types of executive pay nor do they give shareholders the right to override decisions previously made by the board. Proponents also note that the leading "say on pay" proposals would apply only to the top executives and only to public companies. Finally, proponents of the legislation cite the success of the U.K. "say on pay" rules, which are reported to have promoted increased corporate accountability, a constructive dialogue among shareholders and management, and a closer link between pay and performance.

If "say on pay" legislation is passed as expected, public companies will be faced with additional disclosure requirements and closer scrutiny of executive arrangements. The closer scrutiny fostered by new "say on pay" laws will likely to encourage some companies to more closely align executive pay to performance and will likely discourage certain companies from providing excessive pay packages.

Marjorie M. Glover is the Chair of Executive Compensation and Employee Benefits at Chadbourne & Parke LLP. She is based in the firm's New York office and can be reached at 212-408-1016 or mglover@chadbourne.com.