



SEC ADOPTS FINAL “SAY-ON-PAY” RULES

On January 25, 2011, the Securities and Exchange Commission (“SEC”) adopted [final rules](#) under the Dodd-Frank Wall Street Reform and Consumer Protection Act requiring that companies conduct a shareholder advisory vote on named executive officer compensation at least every three calendar years (a “Say-on-Pay Vote”), a shareholder advisory vote on the frequency of the Say-on-Pay Vote at least every six calendar years (a “Frequency Vote”), and a shareholder advisory vote on golden parachute compensation when seeking shareholder approval for various corporate transactions (a “Say-on-Parachutes Vote”).

There are no major substantive changes between the final rules and the [rules as proposed](#) by the SEC in October 2010. While the final rules are not effective until 60 days following their publication in the Federal Register, most calendar year-end public companies should be familiar with and in the process of implementing the Say-on-Pay rules.

HIGHLIGHTS OF THE FINAL SAY-ON-PAY RULES AND OUR INITIAL OBSERVATIONS

Say-on-Pay Vote. Companies must present the Say-on-Pay Vote in the form of a resolution, although no specific language is prescribed. The final rules include the SEC’s simple, nonexclusive example, which is:

“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.”

Initial Observations. Effective Say-on-Pay Vote proposals will be clear and concise, be simple to read, and, most importantly, make persuasive arguments as to why the compensation paid to the named executive officers was commensurate with the company’s performance for the prior year. Consider using the SEC’s nonexclusive example as the baseline for your Say-on-Pay Vote resolution.

Frequency Vote and Board Recommendation. Like the Say-on-Pay Vote, the Frequency Vote must be presented in the form of a resolution. Importantly, the final rules clarify that if the board of directors does not make a Frequency Vote recommendation, the company will not be able to vote uninstruced proxy cards for its Frequency Vote proposal.

Initial Observations. Although the Frequency Vote must take the form of a resolution, shareholders will have a choice to vote for annual, biennial, or triennial frequency, or to abstain from making a selection. As of the date of this *Commentary*, most companies that have filed their definitive proxy statements for 2011 continue to recommend a triennial vote. We continue to believe that the frequency recommendation depends on each company's particular facts and circumstances, but our sense is that, absent unusual situations, most companies should recommend annual Say-on-Pay Votes for the following reasons:

- Many investors and shareholder advisory firms (e.g., ISS) strongly prefer annual Say-on-Pay Votes;
- Annual Say-on-Pay Votes avoid the question of how management's annual compensation compared to company results over a multi-year period;
- Annual Say-on-Pay Votes may "routinize" the vote (as they have in the European Union); and
- Annual Say-on-Pay Votes provide an outlet to protest compensation practices that may shield compensation committee members and equity plans from negative or withhold votes.

It also should be noted that, just this week, shareholders of Monsanto Company sided with ISS in approving an annual Say-on-Pay Vote even though the board of directors had recommended a triennial frequency (but shareholders went against ISS and voted for Monsanto's Say-on-Pay resolution). Following the vote, Monsanto quickly adopted an annual Say-on-Pay Vote.

Disclosure of Voting Results, Frequency Policy, and Next Say-on-Pay Vote. Companies must file a Form 8-K (Item 5.07) reporting the results of the meeting, including the Say-on-Pay Vote and Frequency Vote results, and disclosing their decisions regarding how frequently they will conduct subsequent Say-on-Pay Votes. After 2011, each reporting company's proxy statement must also disclose the current frequency of Say-on-Pay Votes and when the next Say-on-Pay Vote will be conducted.

Initial Observations. The key is to monitor your voting results and then take decisive action. The approach reflected in the final rules provides adequate time for companies to consider the Say-on-Pay Vote and Frequency Vote results, and to contact shareholders for discussions, if appropriate, before making a final frequency determination. In cases where there are unexpected voting outcomes, this additional time may be useful in determining the best course of action for your company. When the voting results are closely aligned with the board's recommendation, the frequency decision will be easy. Once the frequency decision has been made, issue prompt and responsive disclosure to show that the board is actively engaged on this matter. A quick and decisive announcement about frequency may also send a strong message of alignment to shareholders where the board of directors and shareholders agree on frequency.

Impact on CD&A Disclosure. Companies must disclose as a mandatory element of their Compensation Discussion and Analysis ("CD&A") whether the company considered the results of the most recent Say-on-Pay Vote in determining its compensation policies and, if so, how that consideration affected compensation policies and decisions.

Initial Observations. Consistent with the principles-based nature of a CD&A, any company that takes earlier Say-on-Pay Votes into consideration as a material factor for its compensation program should disclose and analyze those considerations in the CD&A. In practice, it may be difficult for companies to determine the extent to which Say-on-Pay Votes actually had a material impact on their compensation policies and decisions in subsequent years, especially where many companies are already taking shareholders' and shareholder advisory firms' annual voting guidelines into account when designing and implementing compensation programs.

Effect of Frequency Policy on Similar Shareholder Proposals. Companies may exclude shareholder proposals related to Say-on-Pay Votes or Frequency Votes under Rule 14a-8 if one of the frequency choices (annual, biennial, or triennial) received the support of a majority of the votes cast in the company's most recent Frequency Vote and the company has adopted and disclosed a policy on the frequency of its Say-on-Pay Votes that is consistent with this majority-recommended frequency choice. The final rules also clarify that the SEC will entertain no-action letter requests to exclude shareholder proposals requesting advisory votes on other aspects of executive compensation.

Initial Observations. As noted above, we continue to support annual frequency for Say-on-Pay Votes, and we continue to expect that a majority of shareholders will support annual frequency. If a majority of the votes cast are in favor of annual frequency, companies should strongly consider implementing annual frequency (regardless of the prior board recommendation) so the company can take advantage of the Rule 14a-8 exclusion in future years.

Golden Parachute Compensation Disclosure and Say-on-Parachutes Vote. In connection with an acquisition, merger, or similar transaction, companies must disclose in tabular and narrative format all golden parachute compensation arrangements between the target or acquiring company and the named executive officers that relate to the transaction. The Say-on-Parachutes Vote requirement does not apply if the golden parachute compensation arrangements were subject to a prior Say-on-Pay Vote and have not changed (subject to limited exceptions). The final rules indicate that these rules will be effective for proxy statement filings with the SEC on or after April 25, 2011.

Initial Observations. It remains to be seen to what degree companies will voluntarily include golden parachute compensation disclosure under the new rules in their annual meeting proxy statements; however, we continue to expect that most companies will refrain from including golden parachute compensation disclosure in the new tabular/narrative format in annual proxy statements. Our view is based in part on the fact that changes to previously approved golden parachute compensation would need to be submitted at the time of the vote for the relevant transaction, and that companies will not want to risk a negative vote in the abstract. We also believe that properly structured change-in-control arrangements enhance shareholder value and that companies may be better served by waiting to submit golden parachute compensation to a Say-On-Parachutes Vote at the time of a relevant transaction so that they can effectively articulate their rationale for the change-in-control arrangements.

Stay tuned for what we expect will be more developments and guidance as to these issues as the 2011 reporting season progresses.

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