



Dodd-Frank Executive Compensation Changes

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The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), while primarily directed at firms in the financial services industry, includes changes related to executive compensation that have a significantly broader reach. Many provisions apply to all public companies, some apply only to exchange-listed companies and some exempt foreign private issuers or companies that have only public debt. In some, but not all, cases the body that is charged with drafting the implementing rules has been granted exemptive authority and instructed to take into account the impact on smaller reporting companies.

The executive compensation provisions expected to be generally applicable to U.S. public companies include:

- "Say-on-pay" and "say-when-on-pay,"
- Say on golden parachutes,
- Clawback of compensation paid to executives,
- Compensation committee independence,
- Broker discretionary voting on executive compensation matters,
- Pay versus performance disclosure, and
- Disclosure regarding compensation of the CEO relative to median employee compensation.

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"Say-On-Pay" and "Say-When-On-Pay"

Dodd-Frank's "say-on-pay" provision provides that, beginning with the first meeting of stockholders after January 21, 2011, stockholders must be given an opportunity to cast an advisory, non-binding vote on a company's compensation of named executive officers (NEOs) as disclosed in its proxy statement. A company will need to include a say-on-pay proposal in its 2011 proxy statement; thereafter, it will be required to include a say-on-pay proposal in a proxy statement at least once every three years. Also at the first meeting of stockholders after January 21, 2011, stockholders must be given the right to vote, again on an advisory basis, on how often the company should present a say-on-pay proposal to stockholders (annually, biannually or triennially). Companies must submit such a say-when-on-pay proposal to stockholders at least once every six years.

Although both say-on-pay and say-when-on-pay proposals are non-binding, actions taken by a company in contravention of a majority stockholder vote could be problematic from an investor relations perspective and could result in votes being withheld from or cast against directors, particularly members of the compensation committee, in the next election.

While these changes are effective for the 2011 proxy season, Dodd-Frank

as drafted raises a number of interpretive issues that the Securities and Exchange Commission (the "SEC") is expected to address, including whether proxy statements containing say-on-pay proposals will require filing of a preliminary proxy. Another issue to be resolved is how the say-when-on-pay proposal is to be presented to shareholders, since it is currently contemplated that stockholders be given the option of one, two or three years, but if none of the options receives a majority vote, what is the result when the corporate law in many states, including Delaware and Colorado, requires a majority vote to approve this type of proposal?

Vote on Golden Parachutes

In any proxy statement relating to an acquisition, merger or sale of substantially all assets, shareholders must be given an opportunity to cast a separate, non-binding vote on compensation arrangements of NEOs that are based on or otherwise related to the transaction. No separate vote is required at the time of transaction if the change of control compensation arrangement has previously been the subject of a say-on-pay vote.

Clawback of Compensation Paid to Executives

Dodd-Frank requires the SEC to develop new rules regarding the recovery, or "clawback," of any excess incentive compensation based on financial information received by executive officers within three years of an accounting restatement. Stock exchanges will be required to amend their listing standards to require that every listed company adopt a clawback policy. The policy must be publicly-disclosed and must provide that, following an accounting restatement due to material noncompliance with any financial reporting requirements under the securities laws, the company will seek repayment from any current or former executive officer of any incentive-based compensation (including stock options) that was (i) based on the erroneous data, (ii) paid during the three-year period preceding the date of the accounting restatement, and (iii) in excess of what would have been paid under the accounting restatement.

Dodd-Frank's clawback requirements are similar to, but generally broader than, those of the Sarbanes-Oxley Act of 2002 ("SOX"). Dodd-Frank's clawback requirements (i) do not require evidence of misconduct, (ii) apply to all executive officers (not just the CEO and CFO), and (iii) impose a longer recoupment period of three years preceding a restatement (as opposed to 12 months following the filing in which the material misstatement is contained). Dodd-Frank's clawback requirements, however, limit the recovery to the excess compensation received, whereas the SOX clawback provision covers all incentive compensation received.

No effective date is specified for this provision.

Compensation Committee Independence

Dodd-Frank requires the SEC to direct each national securities exchange to amend its listing standards to require every listed company to have a compensation committee consisting solely of "independent" directors. Dodd-Frank's independence requirements would be in addition to existing stock exchange requirements and comparable requirements under Section 16 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Section 162(m) of the Internal Revenue Code. Dodd-Frank directs the SEC to issue, by July 16, 2011, rules setting forth the factors to be considered in determining independence, including non-

board-related compensation received by the director and any affiliate relationship between the company and the director. The Dodd-Frank requirements may be significantly more restrictive than existing rules. For example, Dodd-Frank introduces the concept of affiliate status as a factor to be considered in the determination of independence, which could disable persons affiliated with significant stockholders from serving on compensation committees.

The requirement for an independent compensation committee does not apply to foreign private issuers, and it is unclear whether it applies to companies that have only listed debt.

Dodd-Frank also states that a company's compensation committee must have the authority to engage compensation consultants, legal counsel and other experts without any oversight from the remainder of the company's board of directors or from management, and requires companies to provide funding for such advisers. Dodd-Frank also requires a compensation committee to consider, when engaging a compensation consultant or other advisor (including legal counsel), specified factors relating to the independence of the advisor. This may lead to more compensation committees examining the ability of company counsel to also advise the compensation committee.

Broker Discretionary Voting on Executive Compensation Matters

Dodd-Frank amends the Exchange Act to require each national securities exchange to prohibit broker discretionary voting on executive compensation matters. On August 4, 2010, the New York Stock Exchange issued an information memorandum to notify its members that it intends to amend its Rule 452 to prohibit its members from voting on matters related to executive compensation, including say-on-pay proposals, unless brokers have received instructions from the beneficial owner of the shares. This change will likely result in institutional stockholders, and proxy advisory firms, having increased influence over the outcome of stockholder votes on executive compensation matters.

Pay Versus Performance

Dodd-Frank directs the SEC to promulgate rules requiring disclosure of the relationship between executive compensation actually paid and the financial performance of a company, with the details of that disclosure to be determined by the SEC. Dodd-Frank does not indicate what aspects of a company's financial performance should be considered for the purposes of this disclosure, though it does state that financial performance should take into consideration changes in stock price and dividends.

Relative Compensation of CEO to Median Employee Compensation

Dodd-Frank directs the SEC to require companies to disclose (i) the total annual compensation of the company's CEO, (ii) the median total annual compensation of all of the company's other employees and (iii) the ratio of the median employee compensation to that of the CEO. The total compensation for all employees is to be calculated in accordance with the same procedures as is used in determining executive compensation, which includes many non-cash compensation components. Without regulatory relief, these calculations will be extremely complicated, time-consuming and expensive. Details on how this information is to be calculated and presented will be included in an SEC release, but the SEC has indicated that this is unlikely to be completed in time for the 2011

proxy season.
