



SEC and Executive Compensation Shareholder Proposals

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Introduction

In advance of this current proxy season, numerous companies received shareholder proposals for inclusion in the companies' proxy materials seeking to effect changes in their executive compensation practices. In turn, many of the companies that received those requests have asked the Securities and Exchange Commission's (Commission) Division of Corporation Finance (Division) to issue a no-action letter. By issuing a no-action letter, the Division's staff indicates that if the subject shareholder proposal is excluded by the company from its proxy materials, the Division will not recommend to the Commission that enforcement action be taken against the company. The Division has issued three no-action letters permitting exclusion of proposals to limit the actual amount of compensation. In addition, the Division has issued a no-action letter to a company permitting exclusion of a proposal to give its board "clawback" powers (i.e., the ability to recoup compensation previously paid to executives that it deems was awarded inappropriately). Alternatively, the Division declined to issue no-action letters that would have allowed two other companies to exclude proposals for "say on pay"—an opportunity for shareholders to have a non-binding, advisory vote on executive compensation arrangements.

Say on Pay

"Say on pay" has already gained some traction as a method by which shareholders can exert influence on the structure of executive compensation arrangements. For example, last November, Microsoft Corporation's board of directors approved a "say on pay" plan to allow its shareholders the ability to cast a nonbinding advisory vote on the company's senior executive compensation plan every three years. Around the same time, a narrow majority of shareholders of Cisco Systems Inc. approved a shareholder proposal for a similar shareholder opportunity to vote on that company's executive compensation plan. Indeed, the shareholder that submitted the "say on pay" proposal to International Business Machines Corporation (IBM) maintained that over 30 companies have voluntarily agreed to implement say on pay.

Nevertheless, some companies—Honeywell International Inc. (Honeywell), Exxon Mobil Corporation (Exxon), and IBM—requested no-action letters from the Division on the "say-on-pay" proposals they had received. The Division has responded to the Honeywell and IBM requests by indicating that it is unable to concur in their view that the companies may exclude the proposals from their proxy materials.¹ The Division has yet to respond to the Exxon request.

Clawback

A growing number of companies, especially large companies, are including "clawback" provisions in employment agreements or incentive compensation policies. Generally, bonus payments or grants of stock or options can be rescinded or deferred, for instance, if the executive has entered into a transaction that has caused the company to take excessive risk, or if the payments/grants were based on faulty financial reports (even if the executives were not directly responsible for the incorrect numbers).

As distinguished from these "clawback" provisions, the shareholder proposal submitted to Verizon Communications Inc. (Verizon) was narrower. It asks the Verizon Board to take the steps necessary to assure that Verizon may reduce or "clawback" future payments of long-term incentive compensation to senior executives by up to 100 percent, if Verizon shareholders have received stock in a spin-off or divestiture of Verizon assets, and that stock has lost all, or a substantial amount of its initial value, within five years of receipt. Although the Division issued a no-action letter in response to Verizon's request, its sole basis for issuing the letter was that the shareholder had failed to provide documentary support indicating that it has satisfied the minimum ownership requirement for submitting a proposal. The Division declined to address whether the proposal could also be excluded on an alternative basis for being vague or misleading.²

Compensation Limits

Shareholder proposals to place actual limits on the amounts of remuneration paid to executives are probably the most confrontational and direct method of inserting shareholders into a board's decision making process for approving executive compensation packages. Occidental Petroleum Corporation (Occidental) received a shareholder proposal that calls for the Occidental directors to ". . . eliminate all remuneration for anyone of Management in an amount above \$500,000 per year, eliminating possible severance pay and funds placed yearly in a retirement account." In response to Occidental's request for a no-action letter, the Division issued what is essentially a conditional letter. It acknowledged that there appears to be some basis for Occidental's view that it may exclude the proposal, because the proposal may cause Occidental to breach existing compensation agreements. However, the Division noted that this defect could be cured if the proposal were revised to state that it applies only to future compensation

¹ Rule 14a-8(i) of the Securities Exchange Act of 1934 (Exchange Act) lists 13 bases on which a company may rely to exclude shareholder proposals from the proxy. The companies seeking to exclude these "say on pay" proposals typically maintain that the basis for exclusion is under Rule 14a-8(i)(3), as being vague, indefinite, and misleading.

² The Division also issued a no-action letter to Verizon on a different shareholder proposal related to executive compensation. That proposal was seeking to have the Verizon Board adopt a policy whereby future grants of long-term incentive awards to senior executive officers in the form of performance share units would only vest and become payable to the extent that total shareholder return—a measure of share price appreciation—was equal to or exceeded an index of peer companies.

agreements. The shareholder proponent was given a seven-day period to revise his proposal in this manner, and if he failed to do so, Occidental could omit the proposal from its proxy materials without the Division recommending enforcement action.³

Mattel, Inc. sought a no-action letter for a shareholder proposal similar to the Occidental proposal. Mattel maintained that the proposal could be excluded from its proxy materials for two reasons: it was a substantially similar shareholder proposal to one that was included in the company's proxy materials in 2007 that did not receive the support necessary for resubmission; and the proposal pertained to matters of the company's ordinary business operations, namely general compensation matters. In its no-action letter, the Division only relied on the first basis for allowing Mattel to exclude the proposal and declined to address the alternative basis for exclusion.

Exxon also sought a no-action letter for a shareholder proposal similar to the Occidental and Mattel proposals. Exxon asserted that the proposal could be excluded from its proxy materials because it relates to the company's ordinary business operations. The Division issued a no-action letter. It observed that since the proposal relates to compensation

that may be paid to employees generally and is not limited to compensation that may be paid to senior executive officers and directors, it involves general employee compensation matters that can be excluded as concerning the company's ordinary business operations.

Conclusion

During this proxy season, various aspects of executive compensation, in particular, "say on pay," "clawback", and outright limits on compensation have become significant proxy issues for some companies. At the same time, the prominent institutional shareholder advisory firms have tended to support shareholder efforts to exert influence on the executive compensation process. Furthermore, in December 2009, the Commission adopted final rules expanding proxy statement disclosures in several key areas involving compensation for employees generally and not just for the most senior executive officers. As a consequence, companies can expect heightened shareholder scrutiny of the more expansive disclosures of their compensation policies and practices. If those policies and procedures are not adequately explained and justified, the shareholder proposals involving compensation might receive substantial support.

³ There is no public correspondence on the Commission's no-action letter webpage indicating if the original proposal has been revised in accordance with the Division's letter.