

June 30, 2010

Corporate Governance and Compensation
Provisions in Dodd-Frank Financial Reform Bill

The House-Senate committee's approval last Friday of the Dodd-Frank Wall Street Reform and Consumer Protection Act has moved U.S. public companies one step closer to proxy access and a range of executive compensation-related provisions, including "say on pay." The bill would also mandate disclosure with respect to companies' decisions on whether to separate the positions of Chair and CEO, and would eliminate broker discretionary voting on the election of directors, executive compensation and other matters, but has dropped a previously proposed provision that would have made majority voting mandatory in the election of directors. While the timing of enactment is still uncertain, most expect that the bill will ultimately be enacted.

Corporate Governance Provisions

Proxy Access. Like the Dodd bill approved by the Senate last month, the proxy access provisions of the Dodd-Frank bill would expressly authorize the SEC to adopt rules under which shareholders would be able to nominate directors using the company's proxy materials. In the House-Senate conference process, Senator Dodd and others made an effort to specify ownership thresholds and duration of ownership requirements for proxy access, but after intense lobbying against this effort from shareholder activists, it was dropped and the bill leaves these thresholds up to the SEC. The only change from the prior Dodd bill is the addition of a provision that authorizes the SEC to exempt any issuer or class of issuers from proxy access, and that directs the SEC, in considering an exemption, to take into account whether proxy access would disproportionately burden small issuers. Assuming the bill is enacted, focus will shift to the SEC for the exact parameters of the proxy access rules. As we have stated many times before, we believe that the adoption of proxy access rules is dangerous and unwise. (See our prior memos, including "[Proxy Access Revisited](#)" and "[Comments on the SEC's Proxy Access Proposals](#).") But given the likely passage of the Dodd-Frank bill and the likely SEC adoption of proxy access rules, we believe the SEC should carefully consider its eligibility thresholds and otherwise take steps to try to address the many risks that proxy access entails.

Other Governance Provisions. The bill retains the provisions of the prior Dodd bill requiring the SEC to mandate disclosure of whether a company has separated its Chair and CEO positions and why. The SEC has already adopted rules that require similar disclosure, and it is not clear that the bill's mandate goes beyond these previously adopted rules. The bill also would require the stock exchanges to prohibit broker discretionary voting in connection with the election of directors, executive compensation or any other significant matter, as determined by the SEC. While the bill has eliminated provisions that would have required majority voting in the election of directors for all public companies, majority voting has already been adopted voluntarily on a widespread basis among larger companies. Elimination of the statutory mandate, however, will continue to allow companies and shareholders flexibility in designing their own majority voting bylaws and policies.

Executive Compensation Provisions

Say-on-Pay. The bill would require (1) a non-binding shareholder vote, at least once every three years, to approve the compensation of named executive officers at annual or other shareholder meetings for which the SEC requires compensation disclosure, and (2) a non-binding vote, at least once every six years, to determine the frequency of say-on-pay votes. The new requirements would apply to shareholder meetings occurring after the six-month anniversary of the statute's enactment, and therefore likely would affect the 2011 proxy season. A company would have to hold both of the votes described above at the first shareholder meeting occurring after the effective date.

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Earlier versions of the bill required an annual say-on-pay vote; the new terms regarding frequency of the vote thus provide companies and shareholders increased flexibility.

Shareholder Approval of Golden Parachute Compensation. The bill includes new disclosure and shareholder approval provisions relating to “golden parachute” arrangements. With respect to any proxy statement relating to approval of an M&A transaction, the bill would mandate disclosure of any compensation arrangement with a named executive officer, including the aggregate amount of the potential payments, if the arrangement is based on or related to the M&A transaction. In addition, the bill would require a non-binding shareholder vote with respect to any such arrangement, unless previously subject to a say-on-pay vote. These new requirements would apply to shareholder meetings occurring after the six-month anniversary of the statute’s enactment.

Disclosure of Say-on-Pay and Golden Parachute Votes. The bill would require institutional investors that are subject to reporting requirements under Section 13(f) of the Securities Exchange Act to disclose how they vote with respect to company proposals regarding say-on-pay, frequency of the say-on-pay vote and golden parachute compensation.

The Compensation Committee and its Advisors. The bill would require compensation committee members to satisfy independence standards to be established by the applicable stock exchange. In addition, a compensation committee could engage compensation consultants, legal counsel or other advisers to the compensation committee only after considering factors to be promulgated by the SEC that might affect the independence of such advisers. Finally, the bill would authorize compensation committees to retain independent advisers and would require the committees to oversee the advisers they retain. The bill has added an exception from these requirements for a “controlled company” that is more than 50% owned by an individual, group or other entity.

Additional Disclosure. The bill would mandate annual proxy disclosure (1) indicating whether the compensation committee has retained a compensation consultant and whether the work of the compensation consultant has raised any conflicts of interest (controlled companies are exempt), (2) demonstrating the relationship between executive compensation and financial performance, (3) stating the ratio between the CEO’s compensation and the median compensation of all other employees, and (4) indicating whether employees or directors may engage in hedging transactions on company stock.

Clawbacks. The bill would require companies to adopt a clawback policy applicable in the event of an accounting restatement due to material noncompliance with financial reporting requirements and providing for the recovery of amounts in excess of what would have been paid under the restated financial statements from any current or former executive who received incentive compensation (including stock options) during the 3-year period preceding the date of the restatement. In contrast, the clawback provision of the Sarbanes-Oxley Act covers only the chief executive officer and chief financial officer, applies only if the noncompliance results from misconduct, and relates to compensation events during the year following the misstatement.

Financial Institutions. The bill includes additional provisions with respect to “covered financial institutions” with assets of \$1 billion or more. In particular, the new bill would require the appropriate regulators to issue guidance regarding (1) the disclosure of all company incentive compensation structures, and (2) the prohibition of incentive compensation arrangements that encourage inappropriate risks.

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