

## Legal Updates & News

### Legal Updates

---

## House Passes Legislation on Say on Pay and Compensation Committees

August 2009

by [Lawrence R. Bard](#), [Michael T. Frank](#), [David M. Lynn](#), [Lisa DiNoto](#)

---

On July 31, 2009, the House of Representatives passed the “Corporate and Financial Institution Compensation Fairness Act of 2009,” which would require advisory votes on executive compensation for public companies subject to the proxy rules, as well as enhanced compensation committee independence for listed companies. [\[1\]](#)

The legislation, if ultimately enacted, would mandate that all public companies soliciting proxies or consents for an annual meeting must provide for a separate advisory shareholder vote on executive compensation. Further, the legislation would require additional disclosure and a non-binding vote on any compensatory arrangements of executive officers relating to certain extraordinary corporate transactions whenever proxies or consents are solicited in connection with such a transaction.

In addition, the legislation, if enacted, would require the Securities and Exchange Commission (“SEC”) to promulgate rules directing the national securities exchanges to adopt strict standards for the independence of compensation committee members. These rules also would require that compensation committees have authority and funding to retain consultants and counsel, and that such consultants and counsel also be independent from management. These rules would closely track the requirements for audit committees adopted as part of the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”).

### Advisory Vote on Executive Compensation and Golden Parachutes

The legislation would mandate shareholder “say on pay” for all public companies soliciting proxies or consents at an annual meeting (or special meeting in lieu of an annual meeting). The legislation would require companies to provide a separate shareholder vote to approve the compensation of executives as disclosed under the SEC’s compensation disclosure rules (including the Compensation Discussion & Analysis, the compensation tables, the Compensation Committee Report, and related materials). This vote to approve executive compensation would be deemed non-binding on the board and would not be construed as overriding any board decision. Further, the vote to approve executive compensation would not create or imply any additional fiduciary duty of the board. The legislation would require

#### Related Practices:

- › [Corporate](#)
- › [Employee Benefits and Executive Compensation](#)
- › [Public Companies & Corporate Governance](#)

implementation of say on pay for meetings occurring at least six months after final rules were issued by the SEC.

The legislation also would require a separate vote to approve so-called “golden parachute” compensation in the event of an extraordinary transaction. As with the say on pay proposal, this vote would be non-binding and would not be construed as overruling a decision of the board, nor would it create or imply any additional fiduciary duty. Unlike the say on pay proposal, this vote would only be required whenever proxies or consents are solicited in connection with an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all of the assets of an issuer. Disclosure in the proxy or consent solicitation material also would be required, in a “clear and simple” form in accordance with regulations to be adopted by the SEC, regarding these compensation arrangements. For purposes of the legislation, the term “golden parachute” is not defined; rather the legislation covers “any agreements or understandings” that the soliciting person has with the executive officers of a company (or the acquiring company, as applicable) concerning “any type of compensation (whether present, deferred or contingent) that is based on or otherwise relates to the [transaction].”

Exemptive authority would be provided to the SEC, whereby the agency could exempt certain categories of issuers from these requirements, and the legislation would direct the SEC to take into account the potential impact on smaller reporting issuers when determining appropriate exemptions.

### **Compensation Committee Independence and Advice**

The legislation also would take several steps to increase compensation committees’ independence and access to independent advisors.<sup>[2]</sup>

First, the legislation would require that compensation committee members meet stricter standards for independence from management that are similar to the independence standards currently applicable to audit committee members under Sarbanes-Oxley. In particular, the rules would prohibit compensation committee members from accepting any consulting, advisory, or other compensatory fees (other than in their capacity as members of the board of directors, the compensation committee, or any other board committee). As with audit committees, these enhanced independence requirements would apply to all members of the compensation committee. These requirements would be in addition to current independence standards, including those of the stock exchanges.

Second, the legislation would direct the SEC to require exchange listing standards that require compensation committees to have the authority and funding to hire independent compensation consultants, outside counsel, and other advisors. This is similar to the authority that Sarbanes-Oxley mandated for audit committees. In this regard, the legislation would require that the SEC direct the exchanges to adopt standards making compensation committees directly responsible for the appointment, compensation, retention, and oversight of the work of any compensation consultants that they retain, and that such compensation consultants report directly to the compensation committee. Similar provisions would apply with respect to independent counsel and other advisors. In addition, the legislation would require that any proxy statement or consent solicitation statement for a public company’s annual meeting (or special meeting in lieu thereof) disclose whether the compensation committee had retained a compensation consultant satisfying the required standards of independence.<sup>[3]</sup>

The legislation would provide the SEC with the authority to exempt certain categories of issuers from these requirements, taking into account the potential impact on smaller reporting issuers. The SEC’s rules also would be required to provide for an opportunity to cure defects before delisting.

Finally, the legislation would require the SEC to adopt standards for the independence of compensation consultants and other similar advisors hired by compensation committees.<sup>[4]</sup> The SEC would be tasked with conducting a study of the use of compensation consultants meeting the mandated independence standards and the effects of such use.

In adopting rules implementing the compensation consultant provisions, the legislation would direct the SEC to ensure that such rules are “competitively neutral” among categories of consultants and “preserve the ability of compensation committees to retain the services of members of any such category.” Further,

the legislation would provide that its provisions shall not be construed as requiring a compensation committee to implement or act consistently with the advice provided by compensation consultants or other advisors, and that such provisions would not otherwise affect the compensation committee's ability or obligation to exercise its own judgment.

\* \* \*

This legislation is based on the proposal that the administration sent to Congress last month,<sup>[5]</sup> and also has roots in a "say on pay" bill that the House passed in 2007. Various similar legislative initiatives are underway in Congress.<sup>[6]</sup> We will continue to monitor the status of key elements of the reform proposals and provide alerts as the legislative and regulatory process develops.

---

## Footnotes

[1] See H.R. 3269, the "[Corporate and Financial Institution Compensation Fairness Act of 2009](#)." The legislation also would ban incentive-based payment arrangements at financial institutions that encourage "inappropriate risks" that "could have serious adverse effects on economic conditions or financial stability" or "could threaten the safety and soundness" of the financial institution.

[2] The bill defines "compensation committee" to include, where no such committee exists with respect to a given issuer, the independent members of the entire board of directors.

[3] The legislation also would require an institutional investment manager to report at least annually how it voted on any "say on pay" shareholder vote, unless the information is otherwise required to be publicly reported under SEC rules.

[4] While the legislation would require that any compensation consultant or "similar adviser" retained by a compensation committee meet the required independence standards, it does not explicitly include outside legal counsel among the advisers covered by this requirement, as earlier versions had done. In a separate action, the SEC recently proposed enhanced disclosure about the use of compensation consultants, including in certain circumstances the amount of aggregate fees paid to such consultants. See our Legal Update entitled "[SEC Proposes Rules to Enhance Compensation and Corporate Governance Disclosures](#)."

[5] See our Legal Update entitled "[Administration Proposals on Compensation Committees and Say on Pay Would Affect All Public Companies](#)."

[6] For example, Representative Peters (D-MI) recently introduced the "Shareholder Empowerment Act" in the House and Senators Schumer (D-NY) and Cantwell (D-WA) recently introduced the "Shareholder Bill of Rights Act" in the Senate. For more on the Shareholder Bill of Rights Act, see "[Far-Reaching Shareholder Bill of Rights Introduced in the Senate](#)."