## **Corporate and Securities Alert:** Senate Passes Corporate Governance Reform – Legislation Affects Public Company Executive Compensation and Corporate Governance

## ERNWICK & WEST LLP

On May 20, 2010, the Senate passed the Restoring American Financial Stability Act of 2010 ("RAFSA"). The legislation mandates major reforms of the United States financial regulatory system that are designed to prevent future financial crises, but it also includes significant changes to executive compensation and corporate governance rules for all public companies, including say-on-pay, compensation clawbacks, compensation committee and adviser independence, and majority voting for directors. RAFSA, along with a similar bill that was passed by the House of Representatives late last year, now goes to a House-Senate Conference Committee for reconciliation. The resulting compromise bill will be sent to the President for signature, perhaps as early as the July 4<sup>th</sup> recess. For our earlier summaries of related legislation, please refer to our <u>December 18, 2009 Corporate and Securities Alert</u> and our <u>August 5, 2009 Executive Compensation Alert</u>.

Press accounts of the financial reform legislation have largely neglected its corporate governance and executive compensation provisions, although they will mandate major changes in how technology and life sciences companies conduct their affairs. Regulatory initiatives from the Securities and Exchange Commission that dovetail with these provisions, such as proxy access regulation, are also expected to have a major impact. As a result, it is important for public company directors, executives, counsel and advisers to familiarize themselves with the outlines of these reforms and begin to sort out the appropriate adjustments to current corporate practices.

DESCRIPTION OF PROVISION	ORIGINAL HOUSE BILL	RAFSA
Say-on-Pay	Yes	Yes
Annual shareholder advisory vote (non-binding) to approve named executive officer compensation as disclosed in the proxy statement.		Would not impact shareholders' ability to make other executive compensation related proposals.
Golden Parachute Say-on-Pay	Yes	No similar provision.
Shareholders to have an advisory (non-binding) vote on "golden parachute" compensation payable in connection with a change in control if such compensation has not been previously approved by shareholders.		
End Discretionary Broker Voting re Executive Compensation Proposals	No	Yes.
Proposals relating to executive compensation, such as "say-on-pay," would no longer be deemed "routine" matters; brokers would not be able to vote "uninstructed" shares on these proposals.		
<b>Compensation Committee Independence</b> All compensation committee members must be "independent" (no compensation from the Company, other than in their capacity as a member of the board of directors or a member of a board committee).	Independence definition prohibits other compensation for committee members.	SEC would oversee development of exchange listing standards, including consideration of sources of compensation and whether member is affiliated with the issuer.
		SEC could permit exceptions for smaller issuers and could require stronger standards than those currently in place.

Here is a summary of similarities and differences between the original House bill and RAFSA on the topics of executive compensation and corporate governance:

DESCRIPTION OF PROVISION	ORIGINAL HOUSE BILL	RAFSA
Authority to Engage Advisers   The compensation committee must have the authority, funding and sole discretion to retain and obtain the advice of independent compensation consultants, independent legal counsel and other advisers. Company must provide funding.   Note: tax rules generally require similar independence thresholds as a condition to tax deductibility.   Advisers to the compensation committee required to meet independence standards to be established by the SEC.   Note: SEC rules currently require disclosure of whether consultant provides additional services for the Company.	Yes. Requires proxy statement disclosure of whether the committee engaged an independent consultant. No specific reference to similar rules for counsel.	Yes. Sets forth specific factors that affect adviser independence. Advisers, such as consultants or legal counsel, would not be required to be independent, but in selecting advisers the compensation committee would be required to take account of factors, including the other services performed by such advisers and the fees paid, and the business and personal relationships between the consultant, counsel or adviser and the issuer, and the relationships between the adviser's employer and the issuer. Requires proxy statement disclosure of whether the committee engaged an independent consultant, and any conflicts of interest that arose.
<b>Pay-versus-Performance Disclosure</b> Require companies to disclose in their annual proxy statement the relationship between executive compensation paid and the financial performance of the Company.	No	Yes. Disclosure could include reinstatement of stock price performance tables.
Relationship of CEO Compensation to Median Compensation ("Pay Equity") Require disclosure of the median annual total compensation of all employees except the CEO (or equivalent), the annual total compensation of the CEO (or equivalent), and the ratio of those two amounts.	No	Yes
Recovery of Erroneously Awarded Compensation ("Compensation Clawbacks") Issuers must have policy that requires repayment of incentive compensation (including stock options) paid to current or former executives in the three years prior to an accounting restatement that results from the Company's material noncompliance with <b>any</b> financial reporting requirement.	No	Yes. Stock exchanges to implement through listing standards. Disclosure of issuer's policy would also be required.
<b>Employee and Director Hedging</b> Require companies to disclose whether any employee or director is permitted to purchase financial instruments that are designed to hedge or offset a decrease in market value of the Company's securities.	No	Yes
Proxy AccessAmends Exchange Act to clarify that the SEC has the authority to make rules governing process for including shareholder nominees for director in the Company's annual proxy statement.Note:Provides the SEC with statutory authority to move forward with its already proposed proxy access rules.	Yes	Yes

DESCRIPTION OF PROVISION	ORIGINAL HOUSE BILL	RAFSA
Majority Voting for Directors Require majority vote for election of directors in uncontested director elections (plurality in contested elections). Directors receiving less than a majority of the votes cast would be required to tender their resignations; the board must accept the resignations unless it unanimously refuses to do so, in which case it must disclose the analysis used in reaching the decision, citing specific reasons why the decision was in the best interests of the Company and its shareholders.	No	Yes. To be implemented through the stock exchanges. Gives SEC the power to exempt issuers based on size, market capitalization, number of shareholders and other factors. These rules would supplement existing state law rules and bylaws provisions.
Leadership StructureRequire public companies to disclose in the annual proxy statement why the same person serves as chairman of the board and chief executive officer, or different individuals serve in those capacities.Note:Likely already covered by SEC proxy disclosure enhancements that now require a description of the board's leadership structure.	No	Yes

We expect changes to RAFSA in the ordinary course of the legislative reconciliation process. While most of the legislative attention will be on changes to its major financial industry reform measures, the corporate governance and executive compensation elements are also liable to evolve. Generally, we believe the provisions of RAFSA will supersede the provisions of the original House bill. While it is possible that some major governance or compensation-related components of RAFSA will be eliminated (for example, possibly majority voting for directors), the bulk of these changes are likely to become standard requirements within a few months, and issuers are well advised to begin planning for change.

For more information on these or related matters, please contact Scott Spector or Horace Nash.

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