

Client Alert

Latham & Watkins Benefits & Compensation Practice
and Company Representation Practice

Legislative Reform from the Obama Administration: Say-On-Pay and Compensation Committee Independence

The US Treasury Department has proposed legislation to Congress requiring all publicly traded companies to:

- give shareholders a non-binding vote on executive compensation packages (commonly referred to as “say-on-pay”), and
- take steps to ensure that compensation committees are independent in fact, not just in name.

Three other proposals which include similar provisions to the Obama administration’s proposed legislation are currently pending in Congress—the Corporate and Financial Institution Compensation Fairness Act of 2009 introduced by Senator Barney Frank (D-MA),¹ the Shareholder Bill of Rights Act of 2009 introduced by Senator Charles Schumer (D-NY),² and the Shareholder Empowerment Act of 2009 introduced by Representative Gary Peters (D-MI).³ Accordingly, it is likely that some form of these proposals will be enacted soon and clients should begin to prepare for these significant changes.

Say-On-Pay

The administration’s proposed say-on-pay legislation requires all public companies to include a non-binding shareholder vote to approve the

compensation of executives as disclosed in the proxy for any annual meeting held on or after December 15, 2009. Proxy disclosure would include tables summarizing salary, bonuses, stock and option awards and total compensation for senior executive officers, as well as summaries of golden parachute and pension compensation and a narrative explanation of the board’s compensation decisions.

The proposed say-on-pay legislation also would require public companies to include a non-binding shareholder vote on all executive officer golden parachute arrangements as part of the approval of a merger, acquisition or other sale, for votes held on or after December 15, 2009. The proxy rules would mandate disclosure in a clear and simple tabular format of (i) any agreements or understandings with executive officers concerning any type of compensation (whether present, deferred or contingent) that is based on or otherwise relates to the transaction, and (ii) the aggregate total of all such compensation that may (and the conditions upon which it may) be paid or become payable to or on behalf of the executive officer.

While the shareholder votes on these matters are not binding on the corporation or the board of directors, the legislation highlights the growing

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importance of shareholders having a greater voice in approving executive compensation packages.

New Independence Requirements for Compensation Committees

Although the major stock exchanges require that compensation committee members meet certain minimum standards for independence, the proposed legislation is intended to address concerns that the compensation committee members may lack the tools to bargain effectively with executives (who often use their own compensation consultants in negotiating their compensation packages) over complex compensation decisions or may receive advice from consultants or legal counsel that face conflicts of interest.

To address these concerns, the proposed legislation adds three new requirements to promote the independence of compensation committees:

- Compensation committee members will be required to meet stronger standards for independence that are to be issued by the Securities and Exchange Commission (just as Sarbanes-Oxley did for members of audit committees);
- To ensure that compensation committees are receiving objective advice, any compensation consultants and legal counsel hired by the committee must be independent from management; and
- Compensation committees must be given the authority and funding to hire independent compensation consultants, outside counsel and other advisers who can help ensure that the

committee bargains for pay packages in the best interests of shareholders. If the committee decides not to use its own compensation consultant, then it must explain that decision to shareholders.

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Latham & Watkins' Benefits and Compensation and Company Representation Groups are working closely with clients to assist with say-on-pay proposals and compensation committee independence issues. Please feel free to call any of us if we can be of assistance.

Endnotes

¹ http://www.house.gov/apps/list/press/financialsvcs_dem/comp_001_xml.pdf

² <http://thomas.loc.gov/cgi-bin/query/z?c111:S.1074>:

³ <http://thomas.loc.gov/cgi-bin/query/D?c111:1:./temp/~c111sKh8E6::>

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