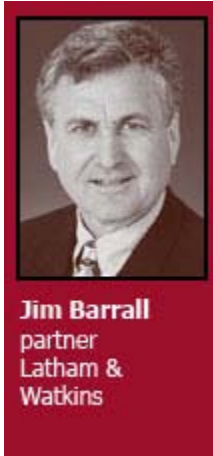


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Opinion: Seize High Ground During Lull in Regulatory Storm

By Jim Barrall



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In the summer of 2008, I participated with several directors and compensation advisors in an [Agenda](#) directors' forum² on navigating the brewing storm on executive compensation. Little did we then know how bad the onslaught would be, as we since have witnessed the meltdown of the financial markets and unprecedented government intervention in corporate boardroom affairs. The backlash has fueled countless regulatory and legislative proposals aimed at executive compensation and related governance practices.

But 13 months after the fall of Lehman Brothers, the panic has subsided. **Federal Reserve** Chairman **Ben Bernanke** has declared the recession over. The Dow Jones Industrial Average has broken 10,000. Domestically, Congress is preoccupied with reforming health care and regulation of the financial services industry. While the TARP companies are facing new criticisms, which will likely gain momentum as 2009 compensation is reported, the storm over executive compensation has abated for non-TARP companies, at least for the moment.

Boards can take some solace in the fact that the proxy access rule proposed by the **SEC** in May 2009 will not be in effect in 2010, as many had expected. Bills requiring majority votes in uncontested director elections and other governance intrusions have stalled.

Further, while say-on-pay legislation has passed the House, it awaits action by the Senate. However, the Senate may act on it as part of an omnibus financial sector regulation bill, which would slow down its likely enactment (in one form or other).

Doubtless, there will be more executive compensation shocks, and politicians and interest groups will use executive pay as a wedge issue to drive their private agendas. But the lull in the storm gives directors an opportunity to reclaim the high ground.

Much of what was said in our summer 2008 directors' forum on executive compensation appears truer today than ever, and worth revisiting. And if corporate America acts on the lessons of the last several years, it could avoid some of the more intrusive pending reforms, or make it easier to live with them if they are adopted. To this end, as companies and directors make year-end 2009 compensation decisions, draft proxies for 2010 meetings and design 2010 compensation plans, they should:

- Demonstrate and disclose that the compensation committee controls the compensation-setting process, that compensation consultants and lawyers report to it and that it controls the terms of their engagements. This is the real issue, not whether the advisors' firms do other work for the company.

- If pressured to adopt say on pay, consider adopting a triennial or biennial vote, as **Microsoft** and **Prudential**, respectively, have done. These options make far more sense than annual votes in evaluating the performance of compensation plans over time and in giving companies time to respond to shareholder concerns.
- Review “poor pay practice” lists published by proxy advisors and institutional shareholders to identify hot-button issues. These are soon to be updated, and violations can expose directors and compensation plans submitted for shareholder approval to negative recommendations and votes.
- Kill any poor pay practices that are third rails or are not important to the company (such as perks, new 280G gross-ups, tax reimbursements on perks, excessive severance benefits), before mailing the 2010 proxy.
- For any important pay practice that might be misinterpreted (like tax reimbursements on broad-based relocation benefits), carefully describe their scope and cost in the 2010 proxy, and explain
 - their justification.
- Review compensation plans to make sure that the plans are balanced and do not create incentives for excessive risk taking. Consider adopting clawbacks, holding requirements and stock ownership guidelines, which go a long way toward addressing risk issues and will help at CD&A-drafting time.

Most importantly, reach out to important and responsible shareholders to dialogue with them regarding executive compensation and governance, through meetings outside of the proxy season, investor surveys and electronic communications such as websites and blogs. Follow the examples of companies such as **Amgen**, **Bristol-Myers Squibb**, **Intel** and **Northrop Grumman**, which have adopted such strategies effectively. Remember that no matter which way the wind will blow, shareholders will continue to have a larger voice on compensation matters. Wise companies will speak directly to them, rather than having proxy advisors usurp this vital power.