

## Congressional and SEC Governance and Compensation Proposals: Scorecard and Action Plan

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For the past six months the air has been thick with SEC proposals and Congressional bills on corporate governance and compensation practices, some of which overlap and others of which supersede prior proposals. We have been covering these developments as they occur in a series of memos linked [here](#). With the 2010 proxy season around the corner, however, we thought it would be helpful to assemble in one place a summary of the current status of each of the proposals, together with a possible action plan based on the changes that we think are likely to be adopted in time to affect calendar year companies. The attached Scorecard summarizes the major governance and compensation proposals now being considered. Note that our focus here is on companies other than financial institutions and “systemically important” companies.

### Status of Proposals

#### A. SEC

(i) **Broker Voting.** The elimination of broker discretionary voting in the election of directors will be in effect for the 2010 proxy season.

(ii) **Proxy Access.** The SEC will not adopt its proxy access proposal in time to affect calendar year companies for the 2010 proxy season. However, Chairman Schapiro has indicated that the SEC is committed to adopting final proxy access rules by early 2010. It appears that at least three commissioners favor some sort of proxy access. However, the Commission and the Staff are thinking hard about changes that could make the current proposal more workable. Modifications to the eligible shareholder nominating standards are likely, including potentially longer holding period requirements, higher share ownership thresholds and net positive ownership position requirements. Similarly, the “first to file” priority is likely to be replaced by a test based on largest shareholder holdings. The Staff is considering how to define the 25% director threshold to eliminate disincentives to renominate incumbent access-nominated directors. There are also active discussions on permitting “opt-outs” from the SEC proxy access requirements for companies whose shareholders adopt alternate proxy access procedures, although activist shareholder groups are either resisting this change or advocating for additional hurdles if opt-outs are permitted.

(iii) **SEC Governance Disclosure.** We continue to expect that the supplemental governance and compensation disclosures proposed last July will be adopted in time for the 2010 proxy season, although the timing of adoption is unclear. We do not expect that there will be significant modifications to the present SEC proposal.

**B. Federal Legislation.** The timing of any corporate governance legislation is highly uncertain, especially given the priority of health care legislation. But we believe that corporate governance legislation in some form will be adopted in 2010 that will authorize the SEC to adopt proxy access rules, and that may also include one or more items from the perennial activist wishlist: majority voting, mandatory annual election of directors, say-on-pay votes, shareholder votes on golden parachutes, compensation committee independence, disclosures on independence of compensation committee advisers, and clawbacks of executive incentive payments in the event of restatements.

### 2010 Proxy Season: Elements of an Action Plan

- *Anticipate Continued Shareholder Activism.* Expect even more activist shareholder requests to include proposals in companies’ 2010 proxy materials. Activist favorites continue to include:

- majority voting proposals (middle market companies will increasingly be a target, as will large cap companies that have “plurality-plus” majority voting policies),
- annual elections of all directors (i.e., elimination of staggered boards),
- independent chair positions,
- shareholder rights to call special meetings at a 10% threshold,
- say-on-pay proposals.

The SEC Staff has indicated that they will permit fewer exclusions of shareholder proposals from proxy statements based on the “ordinary business operations” and “substantially implemented” exclusions. With the table tilted in favor of activists, we expect more companies to seek negotiated resolutions with activists or to adopt their own, more board-friendly alternatives as a means of taking steam out of the activist proposal.

- *Prepare for the New World Without Broker Discretionary Votes for Directors.*
  - Review your recent election results to anticipate the likely impact of the elimination of broker discretionary voting.
  - If necessary, add a “routine” matter to the agenda, such as ratification of auditors, to ensure a quorum.
  - Consider lowering the annual meeting quorum threshold if possible (Delaware Section 216 permits quorum levels to be set as low as one-third).
  - Identify and maintain a dialogue with the principal institutions that own your stock.
  - Analyze proxy advisory policies to determine the likelihood of a “withhold” recommendation. Riskmetrics has indicated that the following practices will continue to result in a withhold vote recommendation:
    - affiliated directors sitting on any board committee that is comprised of independent directors, such as audit, compensation and nominating (note that Riskmetrics has its own “independence” criteria);
    - poor attendance;
    - poor audit practices;
    - compensation practices that RiskMetrics finds offensive (including gross-ups and single-trigger change in control provisions);
    - failure to implement a shareholder proposal that has received a majority vote;
    - implementation of a poison pill without shareholder approval within 12 months
    - directors serving on too many boards; and
    - unilateral action on share exchanges or repricing.
- *Implement SEC Governance Disclosure.* Consider the impact on your proxy disclosure of the likely adoption of the SEC’s governance disclosure proposal. In particular, managements and compensation and nominating committees should be thinking through the format for expanded disclosures of director backgrounds and roles on the board, as well as a discussion of the board’s oversight over risk and the impact that the company’s compensation practices have on its overall risk profile.
- *Prepare for Proxy Access.* If proxy access is adopted in early 2010, companies should review their advance notice requirements, majority vote policies and other areas likely to be affected. We will publish a detailed action plan once the rules are finalized.

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**Scorecard of Governance and Compensation Proposals  
(As of November 20, 2009)**

	<b>SEC Proxy Access and July 2009 Disclosure Proposals</b>	<b>Peters House Bill Proposal<sup>1</sup></b>	<b>Passed House Bill (July, 2009)</b>	<b>Dodd Senate Bill (Proposed November 2009)<sup>2</sup></b>
Proxy Access	<p>1. <u>Rule 14a-8</u> – requires companies to include in proxy materials shareholder proposals concerning election procedures.</p> <p>2. <u>Rule 14a-11</u></p> <ul style="list-style-type: none"> <li>▪ Shareholders may nominate up to 25% of board for inclusion in company proxy solicitation materials</li> <li>▪ Nominees must meet NYSE objective independence</li> <li>▪ Disclose both nominating shareholder and nominee</li> <li>▪ Nomination may be excluded through SEC process on specified grounds</li> <li>▪ Company and shareholder nominees listed individually on single card</li> </ul> <p><u>Eligible nominating shareholders</u> are individuals or groups with share holdings equal to at least:</p> <ul style="list-style-type: none"> <li>- 1% for large accelerated filers</li> <li>- 3% for accelerated filers</li> <li>- 5% for non-accelerated filers; and</li> </ul> <p>must have held shares at least one year and hold through annual meeting, and certify lack of change in control intent.</p>	Same as Dodd Bill		Requires SEC to adopt proxy access rules to permit shareholders to nominate director candidates for inclusion in company proxy solicitation materials.

<sup>1</sup> The Peters Bill is titled the “Shareholder Empowerment Act of 2009”, and was introduced in June 2009.

<sup>2</sup> The Dodd Bill’s corporate governance provisions generally relating to public companies have principally been taken from, and therefore supersede, Sen. Schumer’s “Shareholder Bill of Rights” bill, introduced in May, 2009.

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	<ul style="list-style-type: none"> <li>- If multiple nominees, first to file gets priority.</li> <li>- 120-day advance notice provision for nominating director, unless Company has different advance notice provision</li> </ul>			
Majority Voting		Same as Dodd Bill		<p>Majority vote required in uncontested elections (reverting to plurality for contested elections).</p> <p>Any director with less than majority of votes cast must tender resignation.</p> <p>Board must either accept resignation within a period of time as disclosed or decline to accept and publicly provide the reason within 30 days.</p>
Annual Election of Directors		Required		Permits staggered boards <u>only</u> with shareholder approval or ratification (would require same vote as for amending charter).
CEO and Chair	Proxy statement must disclose reasons for present company governance structure (including lead independent director).	Requires separate CEO and independent chair		Similar to SEC proposal.
Say on Pay		Requires annual, non-binding vote to approve executive compensation	Requires annual non-binding vote to approve executive compensation six months after bill enactment.	Requires annual, non-binding vote to approve executive compensation one year after bill enactment.

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Shareholder Vote on Golden Parachutes		Same as Dodd Bill	Requires approval of golden parachutes, either prior to or at meeting to approve M&A transaction.	Requires non-binding vote to approve executive golden parachutes triggered by M&A, within one year after bill enactment.
Compensation Committee Independence	<p>Disclose any additional service provided by compensation consultants, including fees both for executive compensation and for additional services.</p> <p>Disclose whether decision to retain compensation consultants for additional services was made or recommended by management, and whether board or committee approved.</p>	Similar to Dodd Bill	<p>Compensation committee members subject to similar independence standards as audit committee.</p> <p>Compensation consultants shall meet independence standards to be set by SEC.</p>	<p>Each compensation committee member must be independent, as defined by listing exchanges.</p> <p>Compensation committee consultants, advisers and legal counsel must be independent, as defined by SEC.</p> <p>Compensation committee directly responsible for appointment, compensation and oversight of compensation committee consultants.</p> <p>Company must disclose if compensation committee hired consultants and whether conflict issues raised.</p> <p>SEC must do 3-5 year study on use of compensation consultants and effects of such use on company performance.</p>
Additional Executive Compensation Disclosures	<p>Equity awards to be disclosed at aggregate grant date fair value (changes total compensation reported).</p> <p>Discuss compensation policy and practices for employees (not just NEOs) if risk from policy may have material effect on company.</p>			Disclose relationship between executive compensation and financial performance (including graphic or pictorial comparisons between executive compensation and performance or investor return over 5 years).

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Clawback Policies		Similar to Dodd Bill		Requires clawback of incentive-based compensation from current or former executives based on material non-compliance with any financial reporting requirements that led to accounting restatements, during three year period preceding date on which company is required to prepare the restatement. Amount to be clawed back is amount in excess of payment that would have been made under restated results.
Employee Hedging Disclosure				Requires disclosure of whether employees are allowed to hedge the value of equity grants.
Risk Committees	Disclose board's role in risk management.	Board-level risk committee required		Risk committee required only for certain financial institutions and "systemically important" companies.
Bar Certain Severance Agreements		Yes, if executive terminated for poor performance		
Disclose Performance Targets		Yes		
Other Proxy Statement Disclosure Requirements	<ul style="list-style-type: none"> <li>▪ Disclose particular experience, qualification, attributes or skills that make individual qualified to serve on board and any committees, in light of company's business.</li> <li>▪ Public company directorships during past 5 years.</li> <li>▪ Legal proceedings during past ten years.</li> </ul>			