

THE “RESTORING AMERICAN FINANCIAL STABILITY ACT OF 2010” SUMMARY OF CORPORATE GOVERNANCE AND EXECUTIVE COMPENSATION PROVISIONS

On March 15, 2010, Senate Banking Committee Chairman Christopher Dodd (D-Connecticut) introduced a draft of the Restoring American Financial Stability Act of 2010 (the “2010 Dodd Bill”). The corporate governance and compensation provisions of the 2010 Dodd Bill are similar to those contained in the draft financial reform legislation released by Sen. Dodd on November 10, 2009 (the “2009 Dodd Bill”), with the exception of several key differences that are noted below.

Although a large portion of the 2010 Dodd Bill is intended to address perceived inadequacies in the regulatory regime governing the financial sector, it also contains corporate governance and compensation-related provisions that, if enacted, would have a significant impact on a wide range of public companies outside of the financial sector. Many of these provisions – including majority voting in director elections, “say on pay”, and shareholder access to the ballot – long have been demanded by shareholder activists and certain institutional investors.

Corporate Governance Provisions

- *Majority Voting.* Section 971 of the 2010 Dodd Bill requires the SEC to promulgate a rule directing the national securities exchanges and national securities associations (e.g., NYSE and NASDAQ) to prohibit the listing of any company that does not adopt a majority vote standard in uncontested director elections. Under such a standard, a director receiving less than a majority of the votes cast in an uncontested election would be required to tender his or her resignation. The board of directors would have the right to either accept or decline such a resignation. However, a board choosing to decline the resignation would be required to publicly disclose the specific reasons it chose to do so within 30 days after the date of the vote. The majority vote standard would not apply in the case of contested elections, which would be decided by the vote of a plurality of the shares represented at a meeting and entitled to vote.
- *Proxy Access.* Section 972 of the 2010 Dodd Bill authorizes the SEC to adopt proxy access rules, but does not require the SEC to do so. In this respect, the 2010 Dodd Bill differs from the 2009 Dodd Bill, which would have mandated that the SEC adopt such rules. In June 2009, the SEC proposed a new Rule 14a-11, which would have required, under certain circumstances, that a company include in the company’s proxy materials a shareholder’s (or group of shareholders’) nominee(s) for director. The SEC is expected to act on this proposal in 2010 irrespective of Congressional action or inaction.
- *Disclosure of Chairman and CEO Structure.* Section 973 of the 2010 Dodd Bill directs the SEC to issue rules requiring a company to disclose in its annual proxy statement the reasons why the same person was chosen to serve as chairman of the board of directors and chief executive officer, or, alternatively, why different people were chosen for such roles. The SEC previously adopted enhanced proxy disclosure rules on December 19, 2009, which require disclosure concerning the reasons why the chief executive officer and chairman roles are or are not split. As a result, Section 973 should not have any effect on the *status quo*.

- *Whistleblower Incentives and Protection.* The 2010 Dodd Bill would amend the Securities Exchange Act of 1934, as amended (the "Exchange Act"), to grant the SEC authority to compensate whistleblowers who voluntarily provide original information to the SEC leading to a successful enforcement action. Any such award would be in an amount somewhere between 10% and 30% of the amount of the monetary sanctions collected in such action. In addition, whistleblowers would have an express private right of action against employers who retaliate against them. Finally, the 2010 Dodd Bill would extend the Sarbanes-Oxley whistleblower provisions to subsidiaries and affiliates that are consolidated with public companies for financial accounting purposes.

Executive Compensation

- *Say on Pay.* Section 951 of the 2010 Dodd Bill would amend the Exchange Act to require that any annual proxy statement that requires compensation disclosure include a non-binding shareholder vote to approve the compensation of executives as disclosed pursuant to Item 402 of Regulation S-K.
- *Compensation Committee Independence.* Section 952 of the 2010 Dodd Bill would amend the Exchange Act to require that the SEC promulgate a rule directing the securities exchanges to adopt listing standards that would impose additional independence requirements on public company compensation committees. The SEC's rules would require that listed companies must have a compensation committee consisting of independent directors, and would require that in determining the definition of "independence", the securities exchanges must consider "relevant factors." Such relevant factors would include the source of compensation paid to any director (including any consulting, advisory or other compensatory fee paid by the company to the director) and whether any director is affiliated with the issuer or a subsidiary.

The 2010 Dodd Bill also directs the SEC to identify by rule the factors that affect the independence of compensation consultants, legal advisers and other consultants engaged by a compensation committee. Compensation committees would be required to consider such factors in selecting their advisers. The Exchange Act would be amended to provide that a compensation committee will be directly responsible for the appointment, compensation and oversight of the work of compensation consultants, and to require a company to disclose in its annual proxy statement (i) whether a compensation consultant was retained, and (ii) whether the work raised any conflict of interest and, if so, how the conflict was addressed.

- *Disclosure of Compensation Relative to Performance.* Section 953 of the 2010 Dodd Bill directs the SEC to amend Item 402 of Regulation S-K to require a company to disclose in its annual proxy statement information that shows the relationship between executive compensation actually paid and the financial performance of the company, taking into account any change in the value of the stock and dividends of the company and any distributions. Such disclosure could include a graphic representation of the required information.
- *Clawbacks.* Section 954 of the 2010 Dodd Bill directs the SEC to promulgate a rule that would require listed companies to develop and implement a policy providing (i) for disclosure of incentive-based compensation that is based on publicly reported financial information, and (ii) that in the event a company is required to issue an accounting restatement due to material noncompliance with any financial reporting requirements, the company will be entitled to recover certain amounts from any current or former executive officer who received incentive-based compensation (including stock options) based on the erroneous data during the three-year period preceding the date the company is required to prepare an accounting restatement. The amount of an officer's clawback obligation would be the amount in excess of what would have been paid to the officer under the accounting restatement.

- *Executive and Director Hedging.* Section 955 of the 2010 Dodd Bill directs the SEC to promulgate a rule that would require a company to disclose in its annual proxy statement whether any employee or member of the board of directors is permitted to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars and exchange funds) that are designed to hedge or offset any decrease in the market value of equity securities.

Notable Differences Between the 2009 Dodd Bill and the 2010 Dodd Bill

- *Golden Parachutes.* Unlike the 2009 Dodd Bill, the 2010 Dodd Bill does not contain a provision that would require a non-binding shareholder vote on “golden parachute” payments made to executives upon a change of control.
- *Shareholder Vote on Staggered Boards Not Required.* Unlike the 2009 Dodd Bill, the 2010 Dodd Bill does not include a provision that would prohibit public companies from having boards with staggered terms absent shareholder approval or ratification.

Looking Ahead

The Senate Banking Committee will hold an executive session at 5:00 PM on Monday, March 22, 2010, to mark-up the bill, with the goal of completing its markup by the end of the week. Senate Majority Leader Harry Reid (D - Nevada) has set a Memorial Day deadline for passage of the bill on the Senate floor. The bill would then have to be reconciled with the House’s financial reform bill (Rep. Barney Frank’s “Wall Street Reform and Consumer Protection Act of 2009”), which the House passed in December 2009.

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