SHEARMAN & STERLING LLP

Industrial Conversations Series

Corporate Governance, Clawbacks & Director Compensation

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Lisa Jacobs If you could please tell us a little about our Corporate Governance survey.

Doreen Lilienfeld Sure. For the past fourteen years, we surveyed the corporate governance practice at the 100 largest companies in the United States. And over that longitudinal study, we've been able to see trends in various areas of corporate governance, such as clawbacks and director compensation.

Lisa Jacobs Can you tell us a little bit more about clawbacks? They've been in the news, but what exactly are they, and how are the top 100 companies dealing with them?

Doreen Lilienfeld Well "clawbacks" is really the short-hand word for policies about the recoupment of incentive compensation. Congress and institutional investors have focused on clawbacks as a means of deterring the bad corporate behavior that we find in certain scandals.

Now when Dodd-Frank came along in 2010, a rule was implemented requiring public companies to institute clawbacks of incentive compensation in the event of a restatement of financial statements.

The proposed rules under the clawbacks as requirements of Dodd Frank have not yet been finalized — so we are on the lookout for those. But there are proposed rules and essentially they would require, in the event of a restatement, the recoupment of incentive compensation — so stock and bonuses — from executives at publicly traded companies.

Lisa Jacobs So what exactly triggers a clawback?

Doreen Lilienfeld It's the restatement of financials that would give rise to the trigger. Interestingly in our survey, 90 of the 100 companies that we have looked at have voluntarily implemented clawback policies in advance of the rules — most likely because of the pressure from institutional investors to do so. But, all of those companies are going to have to revisit their policies when the final rules come out from the SEC.

Lisa Jacobs So, let's turn to director's comp[ensation]. What did the survey results show about that?

Doreen Lilienfeld It's interesting because there has been a lot more focus on director comp[ensation] in the past several years.

Previously, the real thrust had been around executive compensation, but director compensation has come into the spotlight. For instance, our survey reveals that meeting fees for directors are a practice that's been dwindling over time and now is getting virtually absent from the largest 100 companies. Simultaneously committee meeting fees have been on the increase, including grants of equity to directors who serve on committees.

Lisa Jacobs Very interesting. Have there been any recent court cases that would be of interest to our audience on director comp[ensation]?

Doreen Lilienfeld Yes, there have been several cases in Delaware regarding director comp[ensation] and setting adequate limits on director compensation.

So, in order for a director's compensation to be considered fair, and not a breach of the duty of loyalty — because remember, directors set their own pay — the director pay needs to be subject to the 'entire fairness standard' under Delaware law. And one of the defenses to the claim that the entire fairness standard has been violated is whether the compensation was granted pursuant to a shareholder approved equity program.

So, the law is developing to say that if the shareholder-approved equity plan has a firm director limit or cap on the amount a director can receive, that those should pass muster under Delaware law.