CLEARY GOTTLIEB

Alert Memo

MARCH 28, 2012

www.clearygottlieb.com

UK Government Consults on Increasing Shareholder Voting Rights in Relation to Quoted Company Directors' Pay

1. Introduction

On 14 March 2012, the UK Government published a consultation on shareholder voting rights in connection with "executive" pay. The consultation follows an earlier discussion paper in which, among other questions, the Government asked whether a binding vote on remuneration would improve shareholders' ability to hold quoted companies to account on pay and performance. The proposals form part of a package of measures the Government intends will address failings in the UK corporate governance framework for executive remuneration.

The proposals apply to the remuneration of directors of UK incorporated "quoted" companies, that is, both executive and non-executive directors of UK companies whose equity share capital is included in the FSA's official list (i.e., not AIM listed companies) or is officially listed in another EEA state or is admitted to dealing on either the NYSE or the Nasdaq. The proposals are expected to affect approximately 1,200 companies.

The proposals comprise three main aspects, which are detailed further below: (a) the introduction of a requirement that quoted companies obtain specific shareholder approval of their remuneration policy and framework proposed for the forthcoming year, with such vote being binding on the company; (b) the introduction of a higher level of shareholder support required for this remuneration policy and framework, likely to be a level between 50% and 75% (with the preservation of the existing level – a simple majority – required for a quoted company's report on its implementation of remuneration policy (including payouts) in the preceding year); and (c) the introduction of a shareholder vote on termination payments to directors in excess of one year's base salary.

The purpose of the consultation is to seek evidence on the impact, costs, benefits and likely behavioural effects of the proposals. The consultation is open for responses until 27 April 2012 and formal legislative proposals are expected in early summer 2012. The Government currently proposes that any such legislation would come into force in spring 2013 and take effect for quoted companies whose accounting periods end (and for directors whose contracts are terminated) after 1 October 2013.

2. An annual binding shareholder vote on forward-looking remuneration policies

2.1 *Existing regime*

Since 2003, quoted companies have been required to include in their annual report a detailed directors' remuneration report, which is approved by an ordinary resolution of shareholders. As well as detailed quantitative information, the report is currently required to include various forward-looking statements of a company's policy on directors' remuneration, including a summary of performance conditions to which share options and LTIP awards are subject, why they were chosen and the methods to be used in assessing whether they are met and a summary of the company's policy on the duration of directors' service contracts and notice periods and of termination payments under such contracts.

However, the Government has expressed concern about the effectiveness of the existing shareholder vote requirement, which does not oblige the company to take any particular action to respond to shareholder concern (and no payout is contingent on the passing of the resolution).

2.2 *Changes to the format and content of directors' remuneration reports*

With the aim of increasing shareholder engagement and company accountability on the issues of executive pay, but in recognition of the legal and practical difficulties of unwinding payouts already made, the Government is proposing that the directors' remuneration report be split into two distinct parts: (a) a part that outlines the proposed remuneration policy for the forthcoming year as well as potential payouts and performance measures in that year; and (b) a second part that explains how in the previous year the remuneration policy has been implemented and provides details of actual payouts and awards already made.

The consultation envisages that the content of each of these two parts will need to change and revised regulations to address this are expected later this year. The content of the report on policy is expected to be significantly expanded and may include, for example, how proposed pay structures reflect and support company strategy and KPIs, how employees' views have been taken into account and how shareholders' views have been sought (and including the results of the previous year's votes on remuneration) and taken into account in adapting its policy.

2.3 *Changes to the shareholder vote requirement*

It is proposed that each of the two distinct parts of the directors' remuneration report will be subject to a separate shareholder vote, at least annually, and that the vote on the forward-looking section will be "binding" on the company (and see part 3 below regarding the proposal to increase the approval threshold on this particular vote).

Whilst the shareholder vote on the forward-looking section will bind the company, such that any proposed changes to the approved policy during the year will be contingent on a further shareholder vote being carried, the Government recognises that shareholders will, for the most part, be approving remuneration policy statements and proposed remuneration structures (which may include maximum potential payouts) and that in most instances the determination of actual awards and payouts will continue to be subject to the discretion of the company's remuneration committee or board of directors (subject to any relevant constraints in the approved policy).

2.4 *Effect of a vote not being passed*

It is proposed that, where a vote is not passed, a company will not be able to proceed with its proposals and will need to revert to the last policy approved by shareholders or otherwise convene within 90 days a further general meeting and put a revised policy to vote.

2.5 *Implications on contracts and new hires*

To reflect the lack of certainty that a particular proposal will necessarily be approved by shareholders, the Government proposes that existing service agreements be amended and no new agreements be entered into that provide for guaranteed entitlements to a particular level of remuneration, as these will need to be subject to shareholder approval of the policy (and so the scope of the potential award) in the relevant year.

The remuneration package for new hires made part-way through the year will be constrained by the remuneration policy approved for that year.

2.6 *Enforcement*

The Government is also consulting on whether directors who enter into or authorise a contractual term that is inconsistent with the approved remuneration policy should be liable to account to the company for any loss (with the recipient holding the payment on trust for the company).

3. **An increase in the level of shareholder support required for forward-looking remuneration policies**

As noted above, remuneration reports of quoted companies are currently subject to shareholder approval by an ordinary resolution, passed by a simple majority of members who, being entitled to vote, do so in person or by proxy (or, on a poll, members representing a simple majority of total voting rights). However, the Government is questioning whether this level of vote is sufficient to ensure quoted companies fully engage with shareholders on the issue of executive remuneration.

Whilst the Government proposes to maintain the existing level of shareholder vote required on the part of the report explaining how in the previous year the remuneration policy has been implemented and providing details of actual payouts and awards made, it is proposing to raise the threshold for the part of the report that outlines the proposed remuneration policy for the forthcoming year as well as potential payouts and performance measures in that year. The Government has not yet proposed a specific level, but has indicated that a level between 50% and 75% is likely to be appropriate (recognising that, in a handful of quoted companies, special resolutions requiring a majority of 75% can be defeated by a single shareholder).

Furthermore, although the existing simple majority threshold will remain for the backward-looking section of the report, the Government is proposing that, where a company fails to secure the support of 75% of votes cast on this resolution, the company will be required to issue a statement to the market (e.g., via an RNS) within 30 days detailing the number and proportion of votes for, against and abstained, the main issues shareholders have raised and how the company proposes to work with shareholders to address such issues.

4. Shareholder votes on exit payments to directors that exceed one year's base salary

4.1 *Existing regime*

At present, compensation payments to UK company directors for loss of office are subject to shareholder approval, unless they are paid in discharge of an existing legal obligation (such as a contractual payment in lieu of notice), as damages for breach of such obligation, by way of settlement or compromise of any claim arising in connection with a director's termination of office or employment or by way of pension in respect of past services.

4.2 *Introduction of new vote requirement*

The Government is proposing to introduce a requirement that any exit payment to a quoted company director that exceeds the equivalent of one year's base salary, in circumstances where a director's contract has been terminated early and without notice (given either from the company or the director), be subject to a binding vote of shareholders by ordinary resolution.

Despite the reference to early termination without notice, the paper also indicates that this vote requirement will also affect directors who leave after having served their full notice period, if payments made to them post-termination exceed one year's salary.

Advance approval will not be possible and approval will need to be sought from shareholders on a case-by-case basis after the director's employment or office has terminated.

In advance of such vote, companies will be required to make available to shareholders a memorandum detailing the amounts it proposes to pay, how they have been calculated and why they are deserved.

4.3 *Effect of a vote not being passed*

If shareholder approval is not obtained, the proposed payout would be capped at an amount equal to one year's base salary.

4.4 *Implications on contracts and enforcement*

As with the above, to reflect the lack of certainty that a particular termination payment will necessarily be approved by shareholders, the Government proposes that existing service agreements be amended and that no new agreements be entered into that provide for guaranteed termination payments at a particular level, as these will need to be subject to specific shareholder approval at the relevant time. It is proposed that any contractual term or arrangement that does so will be void.

* * *

If you have any questions, please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under the 'Practices' section of our website at http://www.clearygottlieb.com.

CLEARY GOTTLIEB STEEN & HAMILTON LLP

Office Locations

NEW YORK

One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

WASHINGTON

2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
T: +1 202 974 1500
F: +1 202 974 1999

PARIS

12, rue de Tilsitt
75008 Paris, France
T: +33 1 40 74 68 00
F: +33 1 40 74 68 88

BRUSSELS

Rue de la Loi 57
1040 Brussels, Belgium
T: +32 2 287 2000
F: +32 2 231 1661

LONDON

City Place House
55 Basinghall Street
London EC2V 5EH, England
T: +44 20 7614 2200
F: +44 20 7600 1698

MOSCOW

Cleary Gottlieb Steen & Hamilton LLC
Paveletskaya Square 2/3
Moscow, Russia 115054
T: +7 495 660 8500
F: +7 495 660 8505

FRANKFURT

Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
T: +49 69 97103 0
F: +49 69 97103 199

COLOGNE

Theodor-Heuss-Ring 9
50688 Cologne, Germany
T: +49 221 80040 0
F: +49 221 80040 199

ROME

Piazza di Spagna 15
00187 Rome, Italy
T: +39 06 69 52 21
F: +39 06 69 20 06 65

MILAN

Via San Paolo 7
20121 Milan, Italy
T: +39 02 72 60 81
F: +39 02 86 98 44 40

HONG KONG

Bank of China Tower
One Garden Road
Hong Kong
T: +852 2521 4122
F: +852 2845 9026

BEIJING

Twin Towers – West (23rd Floor)
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
T: +86 10 5920 1000
F: +86 10 5879 3902

BUENOS AIRES

CGSH International Legal
Services, LLP-
Sucursal Argentina
Avda. Quintana 529, 4to piso
1129 Ciudad Autonoma de Buenos Aires
Argentina
T: +54 11 5556 8900
F: +54 11 5556 8999

SÃO PAULO

Cleary Gottlieb Steen & Hamilton
Consultores em Direito Estrangeiro
Rua Funchal, 418, 13 Andar
São Paulo, SP Brazil 04551-060
T: +55 11 2196 7200
F: +55 11 2196 7299