

CAD-032109

To:

Sir Adrian

From:

Nigel Peace

SHAREHOLDER VOTING ON DIRECTORS' REMUNERATION

I attach some notes on the subject for you to muse upon. What I think they show is that the proposition that 'directors should vote on directors' pay' would be very hard to put into practical effect, but not completely impossible. However I would not for a minute suggest that the Committee should pursue the ideas in paragraph 9.

Regards,

Nigel.

Nigel Peace

SHAREHOLDER VOTING ON DIRECTORS' REMUNERATION

Recent developments in the United States

1 Hitherto, shareholder resolutions on executive pay have been disallowed by the SEC on the grounds that they constitute unjustified shareholder interference with the 'ordinary business' of corporations. The SEC is developing new proxy rules however and this year authorised a number of shareholder resolutions on directors' pay for inclusion in proxy material circulated by companies.

2 Details of the resolutions, and the subsequent voting, are annexed. None were passed. Even if they had been, they would not have been binding on the board. Nor is it proposed that such resolutions should be binding in future. Nevertheless, it is reasonable to suppose that, if adopted, shareholder resolutions would have a substantial influence on a board. (If a majority of shareholders can be mustered to pass a resolution on pay, it must be supposed that a majority can also be mustered to vote to remove the board.)

3 Comment by SEC officials a year ago suggested that the SEC would be sympathetic to shareholder resolutions aimed at reforming the compensation process or setting criteria for executive pay (particularly if framed as proposals for amending the company's bylaws), but not those which specified particular compensation amounts for individual directors.

4 Press comment in the US in February this year referred to the risk for the SEC that, once the new proxy rules were introduced, they would be deluged with calls to pass judgement on individual shareholder resolutions on pay which corporate lawyers wished to omit from proxy material on the grounds for example that they reflected personal grievances or that the supporting statement contained false or misleading information.

5 Other press comment at the same time however suggested that while individual shareholders might not be slow to submit proposals on executive compensation, institutional shareholders might be less interested. It also pointed out that many stock option plans already required shareholder approval in accordance with various legal requirements. Management-sponsored proposals for establishing or changing stock option plans were commonplace and were the most frequently proposed voting items faced by shareholders. Generally they

received the overwhelming support of shareholders, although opposition to the plans had gradually increased in recent years.

6 The SEC has also been developing new rules on the disclosure of executive pay. The press has speculated that the new rules will inter alia require companies to use a standard formula to calculate the present value of stock options and to report it as a range of possibilities under several different share price scenarios. The press also expects the new rules to require a "compensation discussion and analysis" (CD&A) section in annual proxy materials.]

7 The SEC in fact released its proposed rule changes for public comment two days ago, but the only details I have are the FT article and Hugh Collum's letter of 24 June, both attached.

The UK situation

8 The UK situation is quite different. For example:

- there are no rules prohibiting any particular sort of shareholder resolution, and resolutions are binding if adopted. However to get a resolution on the agenda, shareholders must satisfy the tough rules of s.376 of the Companies Act. This states that any resolution must be on the requisition of not less than 5% of the shareholding, or of not less than 100 members with a combined shareholding of at least £10,000. The resolution must also be circulated at the expense of the requisitionists. (In practice the s.376 provisions are very rarely used.)
- there is no equivalent body to the SEC which could develop detailed rules on what shareholder resolutions should be eligible for inclusion on the agenda of the AGM, or adjudicate in cases of dispute.
- stock option plans do not require shareholder approval (unless there is a specific requirement to this effect in the Articles of Association). The only aspect of directors' remuneration which is subject to shareholders' approval is service contracts in excess of 5 years (s.319).

9 If it were desired to give shareholders more influence over directors' remuneration in the UK, two of the less impractical possibilities would seem to me to be:

a) to amend the Companies Act to extend the aspects of directors' remuneration that require shareholders' approval

It would scarcely be practical to make the whole remuneration package subject to shareholders' approval. This would require circulation to shareholders of full information about all aspects of the package (including details of performance pay, stock options, holiday entitlement, pension arrangements, severance arrangements, and so forth). If shareholders were to reject any particular aspect of the package, or the package as a whole, the director would in practice be forced to resign because he would not be able to be paid.

It would however appear practical to make increases in pay (or at least increases above a certain level), or new bonus or stock option plans, subject to shareholders' approval. If the board's recommendations were rejected, the directors would continue at their previous level of remuneration. In the case of newly recruited directors it might be feasible to make remuneration above a certain level subject to shareholders' approval. If the recommendation was rejected, the directors concerned would be able to be paid a level of remuneration below the limit if they were prepared to accept it.

One can imagine, however, that it would be very difficult to draft new legislation in such a way as to avoid providing plentiful scope for avoidance.

b) to amend the Companies Act to make it easier for shareholders to table resolutions on pay, but at same time disallow resolutions which would have the effect of rejecting compensation packages for particular directors without substituting an alternative package.

It would presumably be possible to amend s.376 of the Companies Act so as to make it easier for shareholders to table resolutions of a certain

class - for example, resolutions concerning the process of setting pay, or the criteria to be used for determining pay levels, or calling for an independent review of pay levels by some sort of arbitrating body.

A prerequisite for these ideas would be full disclosure by the company of proposed compensation levels, so that shareholders knew what they were voting on.

payvote



SmithKline Beecham

Hugh R. Collum
Finance Director/Chief Financial Officer

HRC/sh

24th June 1992

Mr. Nigel Peace,
Committee on Financial Aspects
of Corporate Governance,
P O Box 433,
Moorgate Place,
London EC2P 2BJ.

Dear Nigel,

I thought you might be interested to see the attached memorandum sent to me by our office in Washington. A quite aggressive approach!

I shall be very interested to hear whether you or Adrian have, in fact, met the SEC and heard their views on a face-to-face basis.

Best wishes,

Yours sincerely,

TO: H. Collum R. Torrenzano
D. Jenkins P. Ward
T. Landin R. Williams

FROM: Bob Holland

DATE: June 23, 1992

RE: SEC Rules on Proxy Solicitation and Executive Compensation

At an open meeting of the Securities and Exchange Commission today, Chairman Richard Breeden vowed to have new rules on proxy solicitation and disclosure of executive compensation in place by the 1993 proxy season. The commission voted to propose:

- 1) Rules changes that will make it easier for individuals or groups of shareholders to communicate with each other regarding companies and to lower the cost of complying with proxy regulations.
 - Put management and the shareholder on the same level by requiring the company to run a 700-word statement from dissident shareholders in the proxy, making mailing lists available and allowing a shareholder, who could not afford to mail his message to all shareholders, to mail it to the largest holders.
 - Extend free speech to critics of a company, so that an ad in the Wall Street Journal, a speech or a television interview would not necessarily trigger the obligation of proxy solicitation.

- 2) Changes in the disclosure of compensation of a company's five highest-paid executives, and a requirement that shareholders must be told of the criteria used in setting their pay.
 - Compensation committee would have to state the relationship between company performance in the past year and executive pay.
 - Tables would be required in the 10K showing, for three years, all compensation including salary, bonus, options or golden parachutes, with a listing of what the options would be worth if the stock went up by 50%, 100% or 200% over their 10-year life.
 - The company's return to shareholders would have to be compared to that of the S&P 500.

Breeden said you can't now give a speech, be interviewed on television or even complain about the directors at a company picnic without running afoul of the proxy rules.

While distancing himself from legislation that would seek to control executive pay, Breeden criticized directors of "stagnating" companies who award huge pay increases to the boss. "When a company whose stock has plunged in value 'resets' the management's stock options to lower the strike price, many shareholders ask, 'Who is the board representing?'" he added.

There was general agreement on the commission, but Commissioner Mary Schapiro asked the SEC staff why there was no table showing what options would be worth if the stock went down. She praised the staff, however, for easing the nominee rules to make it easier for an insurgent to seek a seat on the board.

Today's proposals are a continuation of efforts to change the proxy rules that the SEC began in June of 1991, but then withdrew last Fall after getting 900 letters, mostly of complaint. Breeden said he didn't care if he got "900 or 90,000 letters" this time -- the rules will be in place for the 1993 proxies.

United Shareholders Association, the group founded by Boone Pickens, hailed the proposals, saying they "will usher in a new era of activist ownership to help reinvigorate the competitiveness of America's corporations."