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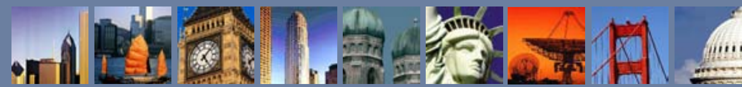
KIRKLAND M&A UPDATE

KIRKLAND & ELLIS LLP



What Every Compensation Committee Should Be Considering Now

The current global economic crisis has thrust executive compensation, and the compensation committees of U.S. public company boards, back into the spotlight. Members of compensation committees should be aware that in today's environment their actions are more likely to draw public scrutiny than ever before, and that a number of recent developments, which on their face may not be directly applicable to non-financial institutions, may nonetheless further tighten the rules governing executive compensation.

Certain of these developments, including the enactment of the financial bailout legislation on October 3, 2008, officially named the Emergency Economic Stabilization Act of 2008,[1] and related regulations of the U.S. Department of the Treasury,[2] most directly impact participating financial institutions. Other initiatives that are being promoted in today's environment, including the efforts to provide stockholders with an advisory vote on executive compensation (sometimes referred to as a "say on pay"), most directly affect those companies who are subject to stockholder activism.

The following is a brief summary of key issues arising from these developments of particular concern to members of compensation committees of U.S. public companies that are not financial institutions.

Executive Compensation and Risk Management — Executive compensation decisions may increasingly be second-guessed for the risks they encouraged executives to take.

The October bailout legislation provides that the Secretary of the Treasury require certain participating financial institutions to meet "appropriate standards for executive compensation and corporate governance."[3] Included in these standards are "*limits on compensation that exclude incentives for senior executive officers of a financial institution to take unnecessary and excessive risks that threaten the value of the financial institution*. . . ."[4] What constitutes an "unnecessary and excessive risk" has been left undefined. Participating public companies will be required to certify their compliance with this requirement annually in their proxy statements. Furthermore, the company's compensation committee will be required to meet with the company's chief risk officer on an annual basis.

What is perhaps most underappreciated is not the direct impact of the October

1 A copy of the Emergency Economic Stabilization Act of 2008 is available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h1424enr.txt.pdf.

2 A copy of the U.S. Department of the Treasury's regulations is available at: http://www.treas.gov/initiatives/eesa/.

3 See Section 111(b)(1) of the Emergency Economic Stabilization Act of 2008.

4 See Section 111(b)(2)(A) of the Emergency Economic Stabilization Act of 2008 (emphasis added).

bailout legislation on participating financial institutions, but what these developments may foreshadow for *all* public companies. In a recent speech, John W. White, Director of Corporation Finance of the U.S. Securities and Exchange Commission, remarked, "Would it be prudent for compensation committees, when establishing targets and creating incentives, not only to discuss how hard or how easy it is to meet the incentives *but also to consider the particular risks an executive might be incentivized to take to meet the target — with risk in this case being viewed from the enterprise as a whole?* I'll let you think about what Congress might want."[5]

In light of this increased focus, members of compensation committees may wish to conduct an independent assessment with the company's senior risk officers to identify any features in the company's executive compensation program that could encourage executives to take "unnecessary and excessive risks." In addition, compensation committees should anticipate increased investor focus (including from RiskMetrics Group) on the interrelation of executive compensation decisions and risk management. Compensation committees may want to ask, among other things:

- Should the company implement so-called "hold until retirement" requirements for equity awards, which proponents argue more closely focus executives on achieving long-term results?
- What mix of time- and performance-based equity awards is appropriate?
- Are vesting periods long enough to provide incentives for long-term performance?
- Should incentive awards be subject to forfeiture or reduction if corporate risk policies are violated, even if targeted performance goals are achieved?
- Should award programs include a component that rewards executives for employing lower risk strategies in achieving desired results?

Clawback Policies — Anticipate increased scrutiny of clawback policies and campaigns for adoption of policies with more stringent recovery features.

The Sarbanes-Oxley Act of 2002 provides a clawback of certain bonus and incentive-based compensation when an "issuer is required to prepare an accounting restatement due to material noncompliance of the issuer, *as a result of misconduct*, with any financial reporting requirement under the securities laws… ."[6] The misconduct criteria imposed by this section has been criticized by some as unnecessarily limiting its utility. Some commentators suggest that any restatement should mandate the executive's return to the company of each related bonus or other incentive award.

Included within the October bailout legislation's standards for executive compensation and corporate governance is a provision for the recovery by the financial institution of "… any bonus or incentive compensation paid to a senior executive officer based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate[.]"[7] Notably, the bailout legislation does not contain a misconduct criteria to trigger a clawback and applies to a broader group of officers than the clawback provided by the Sarbanes-Oxley Act of 2002.

While the October bailout legislation applies on its face only to participating financial institutions, members of compensation committees can expect increased investor focus on clawback policies and a push for adoption of clawback policies with more stringent recovery features than those imposed by the Sarbanes-Oxley Act of 2002.

Say on Pay — Plan for it to soon be a reality for your company.

Lastly, although not included in the final October bailout legislation (only in an earlier proposed version), members of compensation committees should be aware of the growing impetus to provide stockholders with a non-binding, advisory vote on executive compensation.

According to a recent report from RiskMetrics Group, say on pay proposals have received majority support at 11 companies so far this year (with the latest vote at Sun Microsystems receiving 67% support on November 5, 2008). In addition, 12 companies have volunteered to provide advisory votes on compensation.[8]

Supplementing the push being made by governance activists (approximately 67 proposals appeared on company ballots in 2008), is a widespread expectation that draft legislation providing stockholders with a non-binding, advisory vote on executive compensation will likely be signed into law as early as next year. A say on pay bill was introduced by Congressman

5 See "Executive Compensation Disclosure: Observations on Year Two and a Look Forward to the Changing Landscape for 2009," John W. White, available at: http://www.sec.gov/news/speech/2008/spch102108jww.htm (emphasis added).

6 See Section 304 of the Sarbanes-Oxley Act of 2002 (emphasis added).

7 See Section 111(b)(2)(B) of the Emergency Economic Stabilization Act of 2008.

8 A copy of the RiskMetrics Group report, "What's Next on Say on Pay," is available at: http://www.riskmetrics.com/webcasts/governance_exchange_say_on_pay.

Barney Frank (D-MA) on March 1, 2007, and passed by the House of Representatives on April 20, 2007. A comparable Senate bill was introduced to the Senate by President-elect Barack Obama (D-IL) and referred to the Committee of Banking, Housing and Urban Affairs, which is currently chaired by Christopher J. Dodd (D-CT). As of November 16, 2008, the Senate bill had not yet been voted on.

In the wake of the current economic crisis and the recent national elections, members of compensation committees should anticipate a strong push by activists and Congress to require a non-binding, advisory vote on executive compensation at the annual meetings of all U.S. public companies beginning as early as 2010. ■

Meet the Authors

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Theodore Peto concentrates his practice in complex corporate transactions, including going-private transactions, mergers, acquisitions, divestitures, joint ventures, tender offers and securities offerings. Mr. Peto has represented strategic and financial buyers in a variety of public and private transactions, including in the bankruptcy or distressed sale context. Mr. Peto has also represented issuers and investment banks in public and private financings ranging from a few million to several billion dollars. In addition, Mr. Peto regularly advises publicly-traded corporations and their executive officers and directors on a range of general corporate and securities law matters, including SEC periodic reporting and disclosure issues, corporate governance best practices, fiduciary duties and stock exchange listing requirements.

Video Webcast on DealLawyers.com: Fundamentals of Investing in Public Companies

Kirkland & Ellis has teamed up with DealLawyers.com to provide its recent Fundamentals of Investing in Public Companies seminar via video Webcast on Wednesday, November 19, 2008, at 12:00 p.m. EST.

Members of DealLawyers.com can join senior Kirkland attorneys as they discuss the Fundamentals of Investing in Public Companies in three panels: Investing Through the Public Stock Markets, Alternative Investments in Public Companies and Tactics of and Defenses Against Activist Shareholders.

For more information and to access this video Webcast, visit www.kirkland.com/kicp.

About Kirkland's Public Company Practice

Kirkland & Ellis LLP is a leading adviser to public companies on all types of mergers and acquisitions transactions, including tender and exchange offers, going private transactions, acquisitions and dispositions of subsidiaries, divisions and other assets and joint ventures. The firm is able to draw upon leaders in the areas of M&A, corporate governance, securities, tax, antitrust, intellectual property, ERISA and environmental law to provide our clients with comprehensive and innovative advice. We have experienced M&A teams in our domestic and European offices with the capability to execute complex domestic and multi-jurisdictional transactions. Our M&A practice is further bolstered by our extensive experience in corporate governance matters. We routinely counsel boards of directors and executive officers regarding significant transactions, takeover readiness, disclosure issues, Sarbanes-Oxley matters and internal investigations.

Recent Kirkland Deals

NRG Energy, Inc. (NYSE:NRG) in connection with Exelon Corporation's (NYSE:EXE) approximately $6.2 billion unsolicited bid for the company

Constellation Energy Group (NYSE:CEG) in its pending $4.7 billion sale to MidAmerican Energy Holdings Company

ConAgra Foods (NYSE:CAG) in its $2.8 billion sale of the commodity and merchandising business of the ConAgra Trade Group to Ospraie Special Opportunities Fund (an affiliate of Ospraie Management) and other investors

Apax Partners, **Barclays Capital** and **The Tchenguiz Group**, as part of a private equity consortium, in their pending $1.6 billion sale of Somerfield to The Co-operative Group

Vestar Capital Partners in its $1.45 billion acquisition of the North American laundry business of Unilever (LON:ULVR)

Madison Dearborn Partners and **TA Associates** in their €1.1 billion purchase of a minority interest in Weather Investments S.p.A.

ACG Holdings in its $800 million merger with Vertis Holdings

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