



**THOMPSON
HINE**

December 2009

PUBLIC COMPANY UPDATE

RiskMetrics Issues 2010 Updates to Corporate Governance Policy

OVERVIEW

On November 19, RiskMetrics Group released its 2010 Corporate Governance Policy Updates, which are effective for shareholder meetings taking place on or after February 1, 2010. You can find the full text of the updates at <http://www.riskmetrics.com/sites/default/files/RMG2010USPolicyUpdates.pdf>. As proposed in October, the most material updates affect three areas: poison pills, director independence and executive compensation.

POISON PILLS

RiskMetrics codified its policy, largely as interpreted in an April 10, 2009 RiskMetrics FAQ, on separating its vote recommendations for “long-term” and “short-term” poison pills. As proposed in October, RiskMetrics also announced a more frequent review process for companies with poison pills.

- If the board adopts a “long-term” pill (with a term longer than one year), makes a material adverse change to an existing poison pill or renews any existing pill, including a “short-term” pill (with a term of one year or less), without shareholder approval, RiskMetrics will recommend a “WITHHOLD/AGAINST” vote on all director nominees (other than new nominees) unless the board commits to put the pill to a shareholder vote.
- If the board adopts a short-term pill without shareholder approval, RiskMetrics will issue its voting recommendations on a case-by-case basis, considering, without limitation: the date of the pill’s adoption and whether the company had time to present the pill for shareholder approval at the shareholder meeting; the company’s rationale; the company’s governance structure and practices; and the company’s track record of accountability to shareholders.
- RiskMetrics will regularly review companies that have adopted long-term pills or have renewed any existing pill without shareholder approval after November 19, 2009 and will continue to recommend a “WITHHOLD/AGAINST” vote on all director nominees until the pill expires or is redeemed. Companies with classified boards will be reviewed annually, and companies with annually elected boards will be reviewed at least once every three years.

In addition, RiskMetrics amended its policy on net operating loss (NOL) poison pills. Although the voting recommendations will continue to be issued on a case-by-case basis, RiskMetrics will now consider the company’s governance structure, including takeover defenses, board independence and responsiveness to shareholders, as one of the factors in voting determination. RiskMetrics also



adopted a new policy on evaluating NOL charter/bylaw amendments on a case-by-case basis, which mirrors its policy on NOL pills.

DIRECTOR INDEPENDENCE

As proposed in October, RiskMetrics updated its standards for determining director independence. The updated policy changes the test for determining the materiality of transactional relationships between directors and companies and clarifies the definition of professional services.

Transactional Relationships

Pursuant to the new, bifurcated test for evaluating transactional relationships in determining whether a director qualifies as an “independent outside director,” NYSE and Amex-listed companies will be subject to a NYSE-based test of the greater of \$1 million or 2 percent of the recipient’s gross annual revenues, and other companies will continue to be subject to the current NASDAQ-based test of the greater of \$200,000 or 5 percent of the recipient’s gross annual revenues.

Professional Services

RiskMetrics also clarified its definition of “professional services” to include such advisory services that generally involve “access to sensitive company information or to strategic decision-making, and typically have a commission or fee-based payment structure.” A non-exhaustive list of professional services includes insurance, information technology (other than tech support), marketing, lobbying, executive search, property management and real estate agent services. Educational services, however, will no longer generally be considered professional services, as they usually do not involve access to sensitive company information or strategic decision-making and are not typically advisory.

Another update codified RiskMetrics’ current application of the \$10,000 threshold in determining whether a director is an “independent outside director.” Pursuant to the 2009 proxy voting guidelines, a director did not qualify as an “independent outside director” if he or she currently provided (or his or her relative provided) professional services to the company, an affiliate of the company or an officer of the company (or one of its affiliates) in excess of \$10,000 per year. The updates clarify that the \$10,000 threshold is also triggered when organizations with which the director (or his or her relative) is affiliated provide the service to the company.

EXECUTIVE COMPENSATION

RiskMetrics combined its Pay for Performance, Poor Pay Practices and Advisory Votes on Compensation (Management Say on Pay) policies into an Executive Compensation Evaluation policy. The integrated Executive Compensation Evaluation policy consists of three sections: Pay for Performance, Problematic Pay Practices and Board Communication and Responsiveness.



Although RiskMetrics intends the Management Say on Pay proposal, if any, to be the primary route of addressing “problematic pay practices,” depending on the compensation issue, voting recommendations issued under the policy may apply to director elections (primarily compensation committee members), advisory votes on compensation and equity plan proposals.

As proposed in October, the new executive compensation framework includes two material updates: updates to long-term pay for performance alignment and a new risk assessment policy.

Long-Term Pay for Performance Alignment

Policy Overview

As part of its Pay for Performance policy, RiskMetrics will recommend to vote case-by-case on management say on pay, election of directors and equity plans by evaluating the alignment between CEO compensation and performance with regard to total shareholder returns. If there is a misalignment between CEO compensation and performance with regard to shareholder returns, RiskMetrics will continue to recommend to vote “AGAINST” management say on pay and/or election of directors (typically compensation committee members). If a significant part of the CEO’s compensation is attributed to equity awards, and there is an equity plan proposal providing for the CEO’s participation in the plan, RiskMetrics will generally recommend to vote “AGAINST” the equity plan.

Five-Year Alignment

RiskMetrics has traditionally analyzed companies’ *one-year* and *three-year* total shareholder returns and focused on the companies in the bottom half of their industry group. If the company is identified as having a potential pay-for-performance disconnect, RiskMetrics will analyze the Compensation Discussion & Analysis to assess on a case-by-case basis the company’s pay practices and determine whether the increase is a result of non-performance-based compensation.

As proposed in the draft posted for comments in October, the key change to the existing policy is an additional evaluation of long-term compensation alignment. Although the most recent year-over-year changes in compensation will remain a key consideration, the alignment of CEOs’ total direct compensation and total shareholder return will also be assessed over a period of at least *five* years.

CEO Compensation Changes

The draft updates posted for comments in October also indicated that a company may be identified as having a potential pay-for-performance disconnect if it has unchanged or marginally decreasing CEO compensation and the company’s one-year and three-year total shareholder returns are in the bottom half of its industry group. In response to comment letters, RiskMetrics clarified that



compensation changes will be considered, but will not, on a stand-alone basis, result in “AGAINST” vote recommendations.

Risk Assessment

As proposed in October, RiskMetrics added risk assessment to its proxy voting guidelines. In evaluating a company’s compensation practices, RiskMetrics will now include an assessment of those practices that may encourage executives to take inappropriate risks. RiskMetrics suggests that, among other things, guaranteed bonuses, a single performance metric used for short-term and long-term plans, high severance packages, high compensation opportunities in comparison to peers, “mega” annual equity awards that provide unlimited upside with no downside risk and a disproportionate level of supplemental pensions could all encourage excessive risk-taking. In evaluating risky executive compensation practices, RiskMetrics will consider mitigating factors, such as “rigorous” claw-back provisions and “robust” stock ownership guidelines.

OVERALL IMPLICATIONS

- The updates codify RiskMetrics’ policy on short-term poison pills and provide for a more frequent review of all existing pills adopted without shareholder approval. Although in 2010, the review policy will only be applicable to companies adopting or renewing pills after November 19, 2009 (the date of announcement of the policy), in future years, RiskMetrics anticipates to apply this policy retroactively to companies that previously adopted long-term pills.
- RiskMetrics anticipates that the proposed deviation from the NASDAQ-based test for evaluating directors’ transactional relationships with the company would likely increase the number of directors of NYSE companies classified as “independent outside directors.”
- The updates acknowledge concerns expressed in comment letters with regard to evaluation of CEOs’ “marginal” pay decreases, as proposed in draft updates released in October. RiskMetrics’ clarification that compensation changes, on a stand-alone basis, will not lead to an “AGAINST” recommendation will be welcomed by most companies.
- While the addition of risk-assessment is perhaps not surprising in light of similar legislative and regulatory initiatives responding to the recent financial turmoil, the somewhat undefined parameters for assessing risk could be of concern to companies, even though RiskMetrics does not expect that the proposed policy will significantly alter the proportion of its “FOR” and “WITHHOLD” or “AGAINST” recommendations on director nominees, management say on pay or equity plan proposals.
- The new risk-assessment policy could lead compensation committees to give additional consideration to claw-back policies, stock ownership guidelines and other emerging executive compensation and governance practices and to reevaluate whether existing policies are sufficiently rigorous (*e.g.*, whether a claw-back policy is enforceable as currently written).



FOR MORE INFORMATION

If you have any questions, please contact:

Thomas A. Aldrich	216.566.5749	Tom.Aldrich@ThompsonHine.com
Derek D. Bork	216.566.5527	Derek.Bork@ThompsonHine.com
David A. Neuhardt	937.443.6775	David.Neuhardt@ThompsonHine.com
J. Shane Starkey	513.352.6737	Shane.Starkey@ThompsonHine.com

or any other member of our Public Company subgroup.

If you do not wish to receive future communications by email, please send an email with “unsubscribe” in the subject line to **Ellen.Geron@ThompsonHine.com**.

This advisory bulletin may be reproduced, in whole or in part, with the prior permission of Thompson Hine LLP and acknowledgement of its source and copyright. This publication is intended to inform clients about legal matters of current interest. It is not intended as legal advice. Readers should not act upon the information contained in it without professional counsel.

This document may be considered attorney advertising in some jurisdictions. Some of the design images and photographs in this document may be of actors depicting fictional scenes.

© 2009 THOMPSON HINE LLP. ALL RIGHTS RESERVED.