



Executive Pay Reforms

From 1 October 2013, significant new obligations will apply to all public companies quoted on the London Stock Exchange regarding the reporting of directors' remuneration. Companies which are listed on AIM are unaffected. The intention behind the new regime is to empower shareholders when it comes to decisions regarding payments made to directors. This, therefore, places a greater importance on directors developing and monitoring positive relationships and constructive discussions with shareholders.

What are the main changes?

The Enterprise and Regulatory Reform Act 2013 received Royal Assent on 25 April 2013. The final form of the Large and Medium-sized Companies and Groups (Accounts and Reports Amendment) Regulations 2013 (the "**Regulations**") were published at the end of June. These new pieces of legislation include amendments to the Companies Act 2006 (the "**Act**") and impose obligations on listed companies to issue two separate publications on the remuneration of their directors.

1. Directors' Remuneration Policy ("DRP")

Every listed company will have to have a valid DRP in place. Essentially, the DRP should set out how a company will calculate remuneration and severance packages for its directors. It should also set out the company's policy on notice periods that will apply to its directors.

The DRP must be approved by the shareholders at least every three years and any payments made to directors (whether by way of remuneration or for loss of office) must be made in accordance with the DRP's terms. If any payment is made outside the scope of the DRP it will be void unless the company obtains specific shareholder approval. If the company wishes to make any changes to its DRP within the three-year period, such changes will require shareholder approval.

This, therefore, places a great emphasis on the drafting of the DRP. An effective DRP will need to strike the right balance between providing sufficient flexibility for the company during recruitment and severance negotiations whilst still providing the certainty that shareholders will be looking for support for the DRP.

2. Directors' Annual Implementation Report ("DAIR")

Quoted companies will be required to produce a report each year setting out how its pay policy was implemented in the previous financial year. The obligation to produce the implementation report does not differ too greatly from



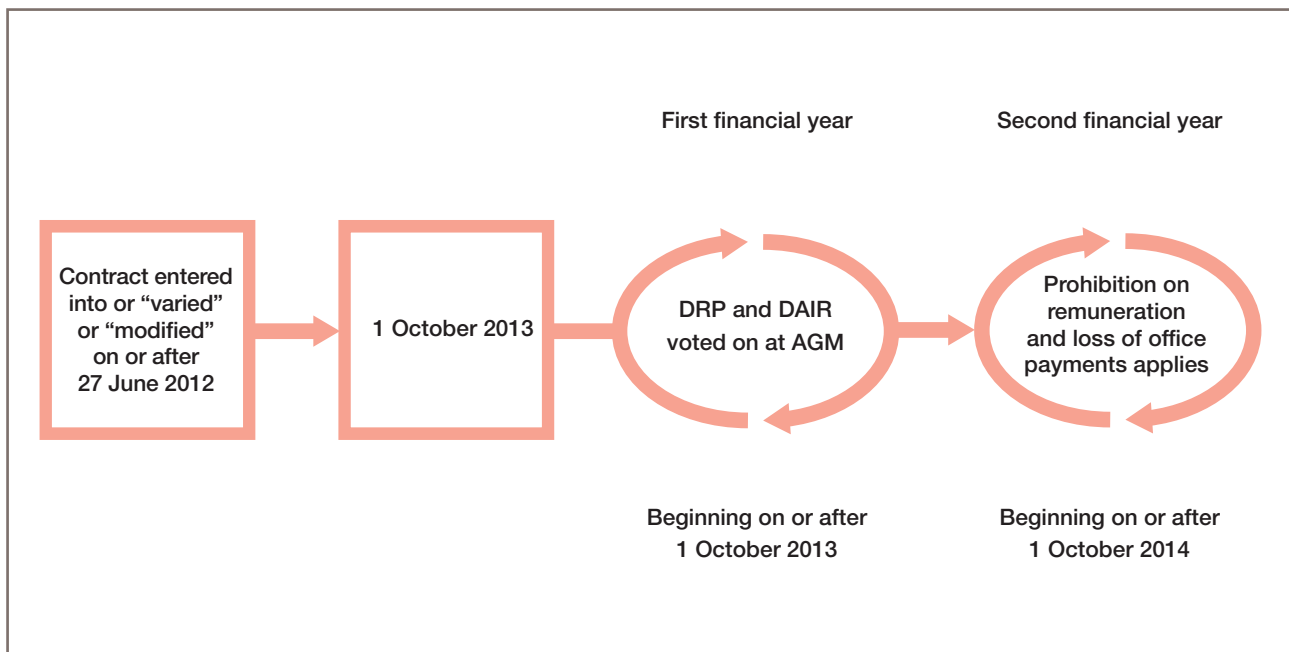
the obligations quoted companies are currently under in producing remuneration reports. However, the content of the report will differ in some ways. In particular, the DAIR should provide detail on the link between the company's performance and pay for that financial year.

The DAIR should include a breakdown of how much each individual director has received, as well as a total cumulative figure for each director. Payments made for loss of office will also have to be disclosed.

The DAIR will be the subject of an annual "advisory vote" by the shareholders. This means that shareholders will be asked to vote by way of ordinary resolution on how the company implemented the DRP policy in the previous year but, as an advisory vote, no remuneration payment will be dependent upon such resolution being passed.

In addition, a new requirement will be imposed on quoted companies to publish any severance payments made to directors who are leaving the business (or ceasing to act as a director). This publication must be made as soon as reasonably practicable on the same company website as its annual accounts are made available.

continued overleaf



When will these changes come into force?

The relevant sections of the Regulations and Act come into force on 1 October 2013 but the implementation of the different rules is staggered, depending on the company's financial year.

A DRP and DAIR will need to be produced and voted upon at the AGM held in the first financial year beginning on or after 1 October 2013. The prohibition on remuneration and loss of office payments being made to directors will apply from the start of the second financial year beginning on or after 1 October 2013.

So, if a company has a financial year that runs from 1 March each year:

- the DRP will need to have been approved in the AGM held between 1 March 2014 and 28 February 2015; and
- the prohibition will have effect from 1 March 2015.

The obligation to publish details of any payments for loss of office on the company's website comes into force on 1 October 2013.

Although the prohibition will only have effect from the start of the second financial year beginning on or after 1 October 2013, it will apply to all payments made after that date including any payments resulting from a contract that was entered into on or after 27 June 2012 (or any contracts that were "modified" on or after that date). Any contracts that were entered into prior to 27 June 2012 will be unaffected, unless they have been renewed or varied since that date.

At present, there is no guidance on the meaning of the term "modification" in this context. As a result, it is unclear whether a change in an employee's job title or a pay rise would constitute a modification for these purposes. Until further guidance is issued on this, it is best to assume any payment made under a contract which has been subject to any form of amendment on or after 27 June 2012 will be caught by the new regime.

What is the effect of non-compliance?

Directors will need to consider carefully how any remuneration or severance packages are put together to ensure that they comply with the DRP.

If a payment is made to a director as part of his or her remuneration package or for loss of office which is not in accordance with the DRP (or is not expressly authorised by the shareholders) it will be void. Directors who authorise any such payment will be held jointly and severally liable to indemnify the company for any resulting loss, although they may be able to benefit from some protection if they can show that they authorised the payments honestly and reasonably.

The company (or the shareholders by way of a derivative action) can make a claim for the void payment to be returned to the company and, in the event that not all of the money is returned, can bring an action against the authorising directors for the resulting loss. It is important to note that the director who was due to receive the now void payment has no recourse against the company or the authorising directors so it will be important to directors to ensure that any payment made to them is in compliance with the DRP.

What you should do now?

1. Confirm timings for the introduction of the DRP and when approval should be obtained (e.g. at the AGM in the first financial year beginning on or after 1 October 2013).
2. Consider and review which contracts will be caught by these provisions. This may require some analysis of whether any contracts entered into before 27 June 2012 have been modified or varied since that date.
3. Develop the DRP for shareholder approval. This is likely to require:

- consideration as to whether any existing incentive or other remuneration arrangements with directors should be reviewed and/or updated; and
- constructive discussions with key shareholders to maximise prospects of securing shareholder approval.

What we can do for you

1. Preparation or review of the DRP

In view of the serious implications of a non-compliant payment, it is critical that the DRP is carefully drafted to cover contractual arrangements that are already in place.

Moving forward, it will also need to incorporate flexibility for directors when negotiating remuneration packages and exit payments, whilst still providing the shareholders with sufficient protection against excessive remuneration packages being awarded.

We can help you to prepare an appropriate DRP in line with the requirements of your business.

2. Contract review

It is important that all of the service agreements and settlement agreements, entered into or modified on or after 27 June 2012, under which payments are still due, are consistent with the drafting of the DRP.

We can conduct a review of all such contracts and can also advise on the terms and wording of any future service agreements or settlement agreements to ensure that directors are seen to be authorising payments honestly and reasonably.

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