

SAY ON PAY FREQUENCY: APRIL 2011 UPDATE

This is our fourth update on trends in Say On Pay and Say When On Pay proposals. In this Alert, we will discuss reasons for failing Say On Pay proposals, including unnecessary risks companies take if they are not properly advised throughout this process. In addition, we will also review the most recent trends in company “frequency” recommendations (Say When On Pay). [Visit our website for the three previous alerts on this subject and other related news.](#)

POOR OR FAILING SAY ON PAY VOTES

Last year, which was the first time most investors saw a meaningful number of Say On Pay proposals, only three companies out of over 300 presenting this proposal (between voluntary presenters and TARP companies) failed to gain approval of their Say On Pay proposals, a failure rate of less than 1%.

Thus far this year, four companies have confirmed their proposals failed (with other companies yet to report their voting results). As this is out of a pool of 146 companies that have already held their meetings and reported their results, this is a failure rate of almost 3%. This may seem small, but anticipating that 5,000 US companies will hold such votes this year, this would project to more than 137 companies that will see their pay programs voted down.

But the results may actually turn out much worse. Of the meetings held thus far, ISS has issued recommendations on 150 companies, of which 18, or 12%, have been negative, including at all four at which Say On Pay has failed (and the balance passed or results are still pending). Extrapolating this through the full year, this would translate into more than 600 companies receiving negative ISS recommendations. So the possibility of receiving a negative ISS recommendation may be far greater than anticipated. Based on these early results, a negative recommendation from ISS appears to be necessary, but not sufficient, for a Say On Pay proposal to fail. **Depending largely on companies’ unique ownership structure and mix of institutional investors, any negative ISS recommendation could put those companies’ votes at risk.** Reasons ISS recommends against generally involve violations of their pay for performance and/or poor pay practices tests, both of which could be predicted fairly reliably in the past, but which increasingly seem to be less predictable.

As we all know from our school days, receiving a passing grade beats failing, but is not the same as “acing” the exam. Applying this concept to the Say On Pay votes, “passing” votes, while certainly better than failing, will not keep companies off of focus lists maintained by proxy advisors, activists and others, of companies where investors “expressed concerns” about aspects of their pay practices and governance generally. Such companies should be prepared to be targeted for closer scrutiny and potential future activism as well.

With that in mind, please consider that, of the first 146 companies reporting their votes, in addition to the 4 that failed, 8 more (or 5.5%) received favorable votes in the 50 – 75% range. Extrapolating this across 5,000 companies to hold these votes this year, then in addition to the 137 projected failures, there would be another 275 companies in the “closer scrutiny”, 50 – 75% range.

While these voting results are non-binding, they bring significant negative visibility to these companies, and put pressure on them to identify and address the underlying factors prior to the following meeting. If they fail to do this, next year they may face additional pressure in the form of withhold recommendations against board members, including members of the compensation committee. As part of the new rules, companies will have to indicate their future frequency selection on a Form 8-K filing within 150 days of the meeting. The rules also require additional disclosure in next year's Compensation Discussion and Analysis (CD&A) regarding whether, and if so how, companies have considered the results of the most recent Say On Pay vote.

MITIGATING RISK OF FAILED SAY ON PAY VOTES REQUIRES YEAR-ROUND PREPARATION

Despite the significant amount of recent regulatory changes, including Say On Pay, it appears that two of the earliest failing companies, Jacobs Engineering and Shuffle Master, did not use the services of any proxy solicitor (at least no such retention was disclosed in their proxies). That said, even the traditional, "from mail date to meeting date", short-term services of traditional proxy solicitors aren't sufficient in scope to help companies mitigate risks in this area.

A comprehensive, year-round approach can help in the following ways:

In advance of the solicitation:

- Project the likely "frequency" voting by your larger institutional investors.
- Inform you of which of your investors practice internally-driven voting, versus which typically follow proxy advisor recommendations.
- Work with you to determine if any of your compensation practices are likely to trigger negative proxy advisor recommendations.
- Review early drafts of your proxy with an eye on clarity and understandability.
- Help you to develop relationships with the governance heads and proxy voters at your larger investors who have demonstrated a willingness to engage with their portfolio companies in advance of proxy season, and share their views, policies and hot button issues.
- This then permits you to fine-tune your proxy disclosures to factor in the intelligence you gain from this pre-proxy dialogue with top investors.

During the solicitation:

- We provide real time interpretation of street-name voting, identifying which significant investors underlie blocks of votes cast anonymously, in custodial (and thus not investor) name.
- Provide experience-based recommendations for selective follow-up solicitation with larger unvoted retail investors, balancing your costs against the likely incremental supportive vote pickup.
- Anticipate and try to avoid "surprise" negative votes and director withholds. Inevitably there will be negative votes, and when this occurs and your senior management and board ask you "did we take all prudent steps to anticipate this and mitigate our risk?" we want your answer to be an emphatic and supportable "yes".

After the meeting:

- We provide a post-meeting analysis of which investors cast negative votes and why. This is necessary to facilitate the next step, which is efficient and effective post-meeting engagement with such investors as part of identifying and then correcting causes of negative voting.
- As your ownership base turns over throughout the year, we provide regular updates on new owners, their voting practices, and degree of proxy advisor reliance.
- We share with you the emerging best practices of our other clients – as well as highlight potential pitfalls, and learn from the mistakes of others before they become your own.

In this process, a frequent mistake companies make is tracking the proposals and voting results of their peer companies and thinking they will have similar results. This makes sense in many areas, as these are the companies you compete against in the markets for talent, as well as for selling your goods and services.

When it comes to proxy voting, however, it's all about your company's unique ownership profile (which may vary significantly from that of your industry peers).

TRENDS IN COMPANY FREQUENCY PREFERENCES – “THE TIMES THEY ARE A-CHANGIN”

- In our second alert, we indicated that, as of January 30, of the first 207 companies to file proposals under the new rules, companies recommended triennial frequency over annual by over a 2 to 1 rate (59.4% triennial, 28.5% annual, 6.3% biennial and 5.8% no recommendation).
- As we reported in our most recent alert, through the end of February this preference by companies for triennial was continuing, though slightly moderated. As of that time, with 296 proxies filed (including the earlier 207), triennial remained the selection of choice over annual, by a 56.1% to 33.4% rate (with the balance almost evenly split between biennial and no recommendation).
- Most recently, this trend is reversing. As the pace of new filings by calendar year-end companies with Spring meetings is accelerating, more recent filers are recommending annual over triennial, such that, by March 31 (the end of Q1), with 909 companies having filed their proxies, annual recommendations for the first time are exceeding triennial, by 54.0% annual to 40.2% triennial (with 3.3% biennial and 2.5% no recommendation). *

TRENDS BY SIZE OF COMPANY

As reported by ISS in their March 24 “Governance Weekly” newsletter, this trend is strongest among larger companies:

- **At the 173 large-cap companies** that have filed proxy materials as of March 22, 105 (60.7 percent) had endorsed annual votes, as compared to 56 companies (32.4 percent) where management endorsed triennial votes. Seven firms have favored a biennial frequency, while five issuers made no recommendation.
- **At the 417 Russell 3000 firms** that had released proxy materials, the number of companies with annual recommendations, which once trailed triennial by a 2-to-1 margin, had climbed to 210 (50.4 percent). Meanwhile, 182 firms (43.6 percent) had backed triennial, followed by 13 issuers with biennial recommendations, and 12 companies that stayed neutral.
- **At 115 small-cap companies outside the Russell 3000**, triennial recommendations remain more prevalent, with 66.1 percent having endorsed votes every three years, as compared with the 24.3 percent that have supported annual votes. **

It would appear that much of this shift in company preferences is in response to early voting results and institutional voting policy disclosures, in which a majority of institutional investors as well as the leading proxy advisors are consistently voting for annual Say on Pay irrespective of company recommendations. At the same time, we note that several of the largest investors are thus far consistently voting for the triennial option (including BlackRock, Capital World/Capital Research, Wellington and others).

In closing, this recent shift in frequency preferences by filers validates the results of a survey of 135 companies conducted by leading compensation consulting firm Towers Watson in mid-December, in which a majority of responders said they were leaning toward recommending annual over triennial.

For more information on how to prepare for SoP and the increasing challenges of the 2011 proxy season, please contact either:

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*Source, Thecorporatcounsel.net and Mark Borges Proxy Disclosure Blogs

**Source, ISS Governance Weekly, March 24, 2011