



## SAY ON PAY FREQUENCY: ANNUAL, BIENNIAL OR TRIENNIAL - REVISITED

In our November 2010 Client Alert we discussed the Dodd-Frank requirement that companies provide shareholders with Say on Pay (SoP) advisory votes on several aspects of executive compensation, including:

1. “Say on Pay”
2. “Say When on Pay” (i.e. the future frequency of Say on Pay votes)
3. “Say on Golden Parachutes” in the event of a merger

At that time, we shared with you some of the key considerations in selecting your recommended frequency including our thoughts regarding which frequency might be endorsed by shareholders, depending on each individual company’s particular circumstances.

### WHAT HAS HAPPENED SINCE THEN?

On January 25, 2011, the SEC adopted rules which differed from the earlier proposed rules in a number of respects. The two most significant changes were:

1. Smaller reporting companies (under \$75 million public float) received a two-year reprieve from these mandatory proposals (i.e., until 2013). That said, during the interim, they might still be subject to shareholder proposals pushing them to voluntarily adopt SoP in 2012.
2. The hurdle to be free from future shareholder-sponsored “frequency” proposals was increased from following the plurality of votes cast, to a) achieving, and then b) following, a majority of votes cast.

In the aftermath of these changes, recognizing that many companies will not achieve a “majority” consensus on frequency, Commissioner Kathleen Casey stated “I fear we may have inappropriately placed our thumb on the scale to ensure that companies and shareholders have no real choice on the frequency vote, but to do what the proxy advisory services recommend” (i.e. annual frequency).

### WHAT COMPANIES ARE DOING

**Now that the first wave of companies has filed their 2011 proxy statements, and several companies have already held meetings under the new requirements, what have we learned?**

As of January 30, proxies had been filed by 207 companies. Within this group, triennial recommendations exceeded annual by more than a two to one margin:

Annual – 59 (28.5%)

Biennial – 13 (6.3%)

Triennial – 123 (59.4%)

No Recommendation – 12 (5.8%)

Interestingly, these early statistics seem to contrast with 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. This difference may be the result of their survey including companies with later Spring meetings which have not yet filed - and some of these may change their minds (or may not), based on the early results.

Of greater significance, the Towers Watson survey revealed that approximately half the responding companies indicated they would be making some adjustments to their “executive pay-setting process” in preparation for the 2011 proxy season. This is consistent with our advice that companies seek to eliminate features that proxy advisors and investors consider “poor pay practices” and which could contribute to poor or even failing Say on Pay votes.

### WHAT INSTITUTIONAL INVESTORS ARE DOING

Phoenix Advisory Partners has had a number of clients that recently held meetings under the new rules, including companies recommending annual frequency versus triennial. This has provided us with a valuable window into early voting by these companies’ investors.

At this early stage, institutional investor voting is following three primary patterns:

1. A majority of investors thus far have voted for annual frequency. This does not mean none of these will ever support less than annual, but at this early stage, they have not yet seen “compelling reasons” not to default to an annual vote.
2. Several very significant investors (significant in that they own thousands of companies, and often are among the top 10 or higher investors in those companies) thus far have supported triennial frequency.
3. Other investors are supporting management’s frequency recommendation. This important, “flexible” group is thus far willing to support less than annual frequencies, except at companies where they may have pre-existing governance or compensation concerns.

Recently, ISS devoted a communication to highlighting the fact that, at Monsanto’s January 25 meeting, investors supported annual frequency over the company’s triennial recommendation by 62% to 36%. While this is quite significant, it is also important to note that had the investors which supported triennial happened to have larger positions than those which supported annual – which could easily be the case at other companies – then the result would have been reversed.

In addition to Monsanto, we are aware of seven additional meetings where companies recommended triennial frequency that were held during the first week under the new rules, and for which results are available.

- Three saw their triennial request approved. At least two of these companies have significant inside or other friendly voting blocs that appear to have supported the companies’ triennial recommendations;
- At the other four companies, shareholders voted for annual frequency by relatively narrow margins at Costco Wholesale (53%), Johnson Controls (59%), and Air Products and Chemicals (60%). At Jacobs Engineering (which apparently did not use a proxy solicitor), shareholders voted for annual frequency by 67%. More significantly, Jacobs was the first company in 2011 to lose on Say on Pay itself, albeit by a slim, 54% majority.

The key takeaway from these early results is that it’s all about your company’s unique ownership profile.

## WHAT ARE THE MAJOR FACTORS IN DETERMINING HOW AN INSTITUTION VOTES?

- Does the investor have a fixed internal policy on frequency?
- Is the policy flexible, and will the investor require annual frequency only of “compensation outliers”?
- Has the company engaged with the investor, gained insight and developed relationship?
- Has the company delivered superior TSR?
- Are the company’s compensation and other proxy disclosures clear and compelling?
- Does the investor follow proxy advisor recommendations?

## HOW PHOENIX CAN HELP YOU NOW

1. Analyze your current owner/voter base, and project the vote on the alternative frequency recommendations. Note that under the draft rules, all 13-f filing institutions will be required to publicly disclose their Say on Pay-related votes at the end of August via form NP-X. Until they do so, Phoenix prefers not to publicly disclose their votes. However, we do share these insights directly with our clients in the course of our consulting and analytical work, including projections of likely voting at their companies.
2. Irrespective of your frequency preference, be sure to tell a good overall compensation story and win on the Say on Pay proposal itself. Recommendations include providing a plain English executive summary to your CD&A, eliminate known problematic pay practices, and let us review an early draft of your proxy.
3. If you have not already done so, there may remain an opportunity for you to engage directly with selected top investors, learn first-hand their hot button issues and informational preferences, and develop a relationship that may prove critical during the live voting period. This will permit you to take these insights back to senior management and the Board, and may guide you in certain of your resultant actions and disclosures designed to secure the support of key investors. We provide our clients with recommendations and a “road-map” for effective engagement.

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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