

Alert

“Say on Pay” at 30 Days — Observations from the First Month

February 25, 2011

Beginning on Jan. 21, 2011, most domestic public companies became subject to the SEC’s new “say on pay” and “say on frequency” rules.

In the first 30 days of the new rules, 95 companies (including TARP recipients) held SOP votes and 92 companies held SOF votes. At 93 of the 95 companies, NEO compensation was approved by shareholders, in most cases by an overwhelming percentage of the votes cast. In contrast, frequency recommendations did not receive nearly as much support:

<u>Frequency Recommendation</u>	<u>Number Proposed</u>	<u>Supported by Majority of Votes Cast</u>
Annual	24	24
Biennial	9	3
Triennial	52	27
No Recommendation	7	N/A

As the vast majority of companies gear up for the 2011 proxy season, there are a number of takeaways from the first 30 days of SOP and SOF.

Say on Frequency

Shareholders have thus far expressed a strong preference for an annual SOP vote. At those companies recommending a biennial or triennial SOP vote, in roughly half of the cases, a majority of the votes cast were voted for an annual vote. At the 7 companies that declined to make a frequency recommendation, in 5 cases, a majority of the votes cast were voted in favor of an annual SOP vote, with biennial and triennial frequency receiving support at one company each. However, at these two companies, there was significant insider ownership, which appears to have made the outcome of the vote a *fait accompli*.

Drilling down on the numbers a little more, at companies with a market capitalization in excess of \$5 billion, shareholders only supported a biennial or triennial recommendation in 3 out of 14 instances, and at 2 of these companies, insiders held in excess of 50% of the voting power. At companies with a market capitalization of between \$1 billion and \$5 billion, shareholders supported a biennial or triennial recommendation at 1 out of 9 companies, with insiders holding in excess of 50% of the voting power at that company. At companies with a market capitalization of less than \$1 billion, shareholders supported a biennial or triennial recommendation in

26 out of 38 instances. Of these companies, 7 had insider voting control of between 20% and 50% and 7 had insider voting control of in excess of 50%.

These early voting results underscore that a biennial or triennial SOP vote recommendation will in many cases be a hard sell. This was especially borne out at larger companies with less insider ownership and large institutional shareholder bases. Institutional Shareholder Services (“ISS”) and many larger pension funds have indicated support for annual SOP votes, which is likely to have had a significant effect on the outcome of the frequency vote at larger companies.

Notwithstanding the mixed success to date of triennial SOP vote recommendations, they are likely to continue to be advanced by many boards. According to ISS, of the 213 companies that had filed proxy materials as of Feb. 16, 126 recommended a triennial SOP vote, 63 recommended annual, 13 recommended biennial and 11 made no recommendation. The group primarily consisted of smaller companies, with only 31 in the S&P 500. Many of the larger companies that have yet to file their proxy materials are expected to recommend an annual SOP vote.

Factors that have been most commonly cited in proxy statements in support of a triennial SOP vote include that (1) a triennial voting cycle is more closely aligned with the performance period under the company’s executive compensation programs; (2) it will provide shareholders with sufficient time to evaluate the effectiveness of incentive programs, compensation strategies and company performance; and (3) it will provide the board and compensation committee with sufficient time to thoughtfully evaluate and respond to shareholder input and effectively implement desired changes to compensation programs. Some of the other factors cited by companies include a high level of prior support for compensation policies by proxy advisory firms, the cost of including an SOP vote in the annual meeting proxy statement every year and that their executive compensation programs do not change significantly from year to year.

At some companies, the thinking will be that, if the board recommends a biennial or triennial frequency and the shareholders nevertheless vote for an annual SOP vote, the board still retains the flexibility to hold an annual vote, so why not try for a less frequent SOP vote if deemed appropriate. However, keep in mind that, if there is a divergence between the board recommendation and the shareholder vote, the board runs the risk of being perceived as out of sync with its shareholder base on SOP or executive pay or governance generally.

As part of determining its frequency recommendation and assessing how shareholders may vote, the board should take into account (1) the company’s investor base; (2) general shareholder voting patterns; (3) shareholder voting history on compensation committee members and compensation matters; (4) the company’s compensation programs and philosophy; (5) peer group frequency recommendations and shareholder votes, if yet known; and (6) investor relations goals. If the board does decide to recommend a biennial or triennial SOP vote, the proxy statement should discuss with specificity the rationale behind the recommendation in order to increase the likelihood of a favorable vote. The supporting statement should therefore avoid generic disclosure that may be perceived as boilerplate.

As part of considering a biennial or triennial recommendation, boards also should consider whether to solicit the views of larger shareholder constituencies in advance of finalizing the recommendation.

Say on Pay

Prior to the commencement of this year’s proxy season, many companies feared widespread negative voting by shareholders on SOP. In the first 30 days, these fears were not borne out. At 93 out of 95 companies, shareholders returned a favorable SOP vote, with an average vote in favor of well in excess of 90% of the votes cast. At the 2 companies that received a negative SOP vote, ISS had taken the position that CEO compensation was not in line with corporate performance.

In 2010, out of approximately 290 SOP votes held, a majority of votes cast were voted against NEO compensation in only 3 instances. Given the number of SOP votes still to come in 2011, now that SOP is mandatory for a much larger group of companies, it is safe to assume that there will be more negative SOP votes than in 2010. Although the vote is advisory in nature, a negative SOP vote can have serious repercussions. The vote may translate into votes against directors. It also is likely to result in significant unfavorable publicity, which was the case at all 3 of the companies that received negative votes on SOP in

2010. In addition, lawsuits alleging breach of fiduciary duty and corporate waste were filed against directors at 2 of the companies that received a negative SOP vote in 2010. In one case, the lawsuit was settled, while it is still pending at the other company. At both of these companies, there also were changes to executive compensation policies and/or leadership.

At the 2 companies that have thus far had negative outcomes on SOP resolutions in 2011, in preparation for a possible lawsuit, plaintiffs' firms already have announced investigations on behalf of shareholders concerning breaches of fiduciary duty relating to historical and potential NEO compensation.

Companies should assess their NEO compensation practices well in advance of filing the proxy statement in order to determine whether they are at risk of a negative SOP vote and, following from that assessment, what pay practices if any should be modified. NEO pay practices that are problematic under ISS policies will affect ISS' SOP vote recommendation.

To help mitigate the risk of a negative SOP vote, companies also should consider whether their CD&A adequately and clearly communicates compensation decisions, philosophy and terms. In addition, if last year's CD&A did not have an executive summary, one should be considered for this year. The CD&A should be viewed as an investor relations communication, and not merely as a disclosure requirement.

Further Information

For a summary of the SEC's new SOP and SOF rules, see our ["Say on Pay' and the 2011 Annual Meeting"](#) and ["SEC Adopts Final Advisory Vote Rules" Alerts](#).

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