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## SAY-ON-PAY VOTES: RECAP OF INAUGURAL SEASON TO DATE

May 25, 2011

Under rules adopted by the Securities and Exchange Commission (“SEC”) implementing the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, most public companies have been required to provide two new shareholder advisory votes in their proxy materials this season. These advisory votes – to approve the compensation of the company’s named executive officers, also known as “say-on-pay,” and to approve the frequency of future say-on-pay votes – have presented shareholders and proxy advisory firms with the opportunity to voice their opinions on executive compensation.<sup>1</sup> We have tracked the approximately 1,600 companies that have included say-on-pay proposals through mid-May 2011 and this client alert highlights certain trends and lessons learned from the results reported on these votes. Click [here](#) to access our survey of the proposals.<sup>2</sup>

### Recap of Results and Board Recommendations

As noted above, as of May 20, 2011, approximately 1,600 companies have filed proxy statements including say-on-pay proposals, and almost 1,500 of these companies also included proposals for the frequency of future say-on-pay votes.<sup>3</sup> With respect to say-on-pay proposals, although the average “for”

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<sup>1</sup> Smaller reporting companies are not required to include proposals for say-on-pay and frequency of future say-on-pay votes until their first annual or other meeting of shareholders for which SEC rules require executive compensation disclosure held on or after January 21, 2013. Some smaller reporting companies, however, have chosen to voluntarily include proposals for say-on-pay and frequency of future say-on-pay votes in their proxy statements this season.

For solicitations made by a company for shareholder meetings at which shareholders are asked to approve an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all of the company’s assets, the company is required to include a separate resolution subject to shareholder advisory vote to approve golden parachutes, unless such agreements or understandings have already been subject to a say-on-pay vote. A few companies have taken advantage of the optional advisory approval of these arrangements in connection with their annual meetings this spring. For more information about the SEC’s say-on-pay requirements in general, see our client alerts at <http://www.wcsr.com/resources/pdfs/cs021411.pdf> and <http://www.wcsr.com/resources/pdfs/cs102710b.pdf>.

<sup>2</sup> Our survey of the proposals filed through May 20, 2011 is available at: <http://www.wcsr.com/resources/pdfs/SayOnPay.pdf>.

<sup>3</sup> Because companies that are recipients under the U.S. Treasury’s Troubled Asset Relief Program (“TARP”) are already required to provide a separate shareholder resolution each year to approve the compensation of executives during the period in which any TARP indebtedness remains outstanding, these companies were not required to include a proposal for frequency of future say-on-pay votes in their proxy statements this season.

vote percentage has been approximately 92%, 24 companies have failed to receive a majority vote on their say-on-pay proposals through May 20, 2011.<sup>4</sup>

Of the companies that have included say-on-pay frequency proposals in their proxy statements, 757 companies, or 51%, recommended an annual vote, 49 companies, or 3%, recommended a biennial vote, 645 companies, or 43%, recommended a triennial vote, and 45 companies, or 3%, did not recommend a frequency. The following chart presents these recommendations by type of filer:

<b>Type of Filer</b>	<b>Annual Vote</b>	<b>Biennial Vote</b>	<b>Triennial Vote</b>	<b>None</b>
Large Accelerated Filer	59%	3%	35%	3%
Accelerated Filer	42%	3%	52%	3%
Non-Accelerated Filer	40%	5%	52%	3%
Smaller reporting company	27%	6%	63%	4%

Whereas large accelerated filers have tended to recommend an annual frequency for say-on-pay votes thus far, accelerated filers, non-accelerated filers and smaller reporting companies have been more likely to recommend a triennial frequency. With respect to shareholder preferences on the frequency of say-on-pay votes, shareholders of large accelerated filers, accelerated filers and non-accelerated filers, in line with the recommendations of proxy advisory firms, have demonstrated a preference for annual say-on-pay votes. The following chart presents the results of the shareholder votes by type of filer:

<b>Type of Filer</b>	<b>Annual Vote</b>	<b>Biennial Vote</b>	<b>Triennial Vote</b>
Large Accelerated Filer	90%	1%	9%
Accelerated Filer	69%	1%	30%
Non-Accelerated Filer	55%	3%	42%
Smaller reporting company	32%	6%	62%

Although shareholders overall have demonstrated a preference for an annual say-on-pay vote, these results indicate that shareholders of non-accelerated filers and smaller reporting companies have voted in favor of a biennial or triennial vote more often than shareholders of large accelerated and accelerated filers.

### **Role of Proxy Advisory Firms in Say-on-Pay Outcomes**

Institutional Shareholder Services, Inc. (“ISS”) and other proxy advisory firms have exerted a significant influence on say-on-pay proposals. ISS has issued negative recommendations on say-on-pay proposals for approximately 12% of the proposals reviewed this proxy season to date. ISS’s primary basis for issuing a negative recommendation appears to be its perceived “disconnect” between a company’s executive compensation and its total shareholder return. For example, ISS argued that

<sup>4</sup> Additionally, based on its proxy statement disclosure of how votes would be counted on its say-on-pay proposal, one company failed to receive majority support for its say-on-pay proposal, but the company nevertheless disclosed that its shareholders had approved the proposal.

Navigant Consulting, Inc. did not tie executive pay to performance goals, as the company granted its chief executive officer a \$275,000 cash bonus despite posting a negative 38.1% shareholder return over the past year. Furthermore, Navigant's proxy materials did not provide many details regarding how the amount of the bonus was derived. Similarly, ISS issued a negative recommendation for Stewart Information Services Corporation because, despite lagging industry peers for the past one- and three-year periods, the compensation for its chief executive officer increased by approximately 30% for the same period and included significant discretionary bonuses for executive officers in 2010.

In issuing negative recommendations, ISS also appears to be influenced by certain practices identified in executive employment agreements. For example, ISS's recommendation against Shuffle Master, Inc.'s say-on-pay proposal was based in part on the company's new employment agreements for its chief operating officer and interim chief executive officer, which contained a modified single-trigger, or "walk-away" provision. This provision allowed for severance payments if the executive officer's employment was terminated for any reason within 90 days of a change in control of the company. Similarly, in recommending a vote against the compensation plans of Hewlett-Packard Company, ISS expressed concerns with the new chief executive officer's employment agreement, which would provide a nearly \$13 million severance package upon his departure.

Although garnering shareholder support for say-on-pay proposals has been more challenging for companies receiving a negative recommendation from proxy advisory firms, negative recommendations have not always translated into a failed say-on-pay vote this season. Several companies have chosen to respond to these negative recommendations by filing additional proxy solicitation materials outlining their disagreement with the methodologies and analysis of ISS and other proxy advisors, while defending the decisions of their respective compensation committees. Although these additional proxy materials have taken various forms – direct communications to shareholders; scripts for employees to make phone calls to certain shareholders; slideshow presentations for employees to use with the media and shareholders; and letters memorializing conversations with proxy advisory firms – they have often served as a useful tool for many companies seeking to provide additional insight with respect to the decisions of their compensation committees. Several companies that have filed these additional proxy solicitation materials, including Morgan Stanley, ConocoPhillips and General Electric Company, have been successful in defending against a negative recommendation for their respective say-on-pay proposals. In addition, The Walt Disney Company's direct negotiations with ISS and the company's ensuing decision to drop the tax "gross-up" provisions from the employment agreements of its chief executive officer and three other executive officers appear to have contributed to ISS' decision to reverse its recommendation against the company's say-on-pay proposal.

Companies have also used the Form 8-K reporting results of votes at their annual meetings as a forum to respond to the recommendations of proxy advisory firms or to respond to failed say-on-pay votes in general. For example, Umpqua Holdings Corporation, after disclosing that only 35% of votes were cast in favor of its say-on-pay proposal, chose to include a narrative in its Form 8-K addressing not only why the company believed that the proposal failed, but also criticizing the methodologies ISS used to arrive at a negative recommendation. Helix Energy Solutions Group, Inc., after disclosing that less than one-third of the votes cast at its meeting were in favor of its say-on-pay proposal, described in its Form 8-K the corrective action its compensation committee planned to take in response to the failed vote.

### **Shareholder Derivative Suits**

Although the failed votes send a clear message to each affected company regarding executive compensation practices, the negative votes may have more far-reaching negative consequences for some companies. With respect to at least two companies thus far this proxy season, shareholder derivative

suits have been filed against members of each company's board of directors, compensation consultants and certain senior officers. Shareholders cited violations of pay-for-performance policies as the general basis for their respective suits. Causes of action cited in these suits included breach of fiduciary duties of candor, good faith and loyalty, corporate waste, unjust enrichment, aiding and abetting and breach of contract. Although the merits of these cases are questionable, they are certainly worth noting as potential collateral consequences of a failed say-on-pay vote.

## **Reporting Voting Results and Frequency Decisions on Form 8-K**

Companies should pay particular attention to their proxy statement disclosure of vote counting mechanics (including the treatment of abstentions under applicable state law) as they relate to the vote required for approval of the say-on-pay vote and the recommended frequency for the say-on-pay vote. There have already been some instances of inconsistencies between a company's proxy statement disclosure on these matters and the voting results reported by the company on Form 8-K or described in a press release following the shareholder meeting.

Effective earlier this year, Form 8-K also requires companies to amend the Form 8-K reporting the voting results, no later than 150 days after the end of the shareholder meeting, to disclose the company's decision as to how frequently it will include a say-on-pay vote in its proxy materials.<sup>5</sup> Some companies have chosen to include this decision in their Forms 8-K reporting the initial voting results. However, companies that do not include this decision in their Form 8-K – either in the initial filing or by timely amendment – should be mindful that failure to meet the deadline for this new reporting requirement can compromise their Form S-3 eligibility.

## **Contact Information**

If you have any questions regarding the executive compensation developments discussed above, please contact Sudhir N. Shenoy (<http://www.wcsr.com/lawyers/sudhir-shenoy>) or Mindy C. Calisti (<http://www.wcsr.com/lawyers/mindy-c-calisti>), the principal drafters of this client alert, or you may contact the Womble Carlyle attorney with whom you usually work or one of our Corporate and Securities attorneys at the following link: <http://www.wcsr.com/profSearch?team=corporateandsecurities>.

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<sup>5</sup> In no event, however, may this Form 8-K be filed later than 60 calendar days prior to the deadline for submission of shareholder proposals under SEC Rule 14a-8 for the following year's shareholder meeting.