

Corporate and Securities Alert

Say-on-Pay: Pay-for-Performance Can Turn an ISS Voting Recommendation

APRIL 28, 2011

Fenwick
FENWICK & WEST LLP

The 2011 proxy season is well underway and companies are taking seriously voting recommendations on Say-on-Pay proposals issued by Institutional Shareholder Services (ISS). Several companies, including, for example, Hewlett Packard, Walt Disney, Unisys Corporation and General Electric (GE) issued shareholder communications arguing against ISS' negative Say-on-Pay voting recommendations. GE went one step further and subsequently imposed performance conditions on Jeffrey Immelt's (GE's CEO) stock options prior to its annual shareholder meeting, which resulted in ISS changing its voting recommendation from "against" to "for" GE's Say-on-Pay proposal. One thing is clear: ISS' preference for pay-for-performance executive compensation is not to be underestimated.

GE's CEO Option Modification Earns a Positive Recommendation from ISS

As recently publicized, ISS initially issued a recommendation to shareholders to vote "against" GE's Say-on-Pay proposal, at least in part due to a perceived misalignment between GE's long-term performance and the CEO's compensation. In particular, it appears that the CEO's 2010 stock option grant to purchase 2,000,000 shares (vesting 50% after three years and 50% after five years) was at issue. ISS indicated that GE's move away from performance-based equity awards for its CEO to time-based stock options for 2010 was not adequately supported.

GE fought back. On April 7, 2011, GE issued a communication to its shareholders challenging ISS' recommendation. GE argued: (1) ISS failed to consider GE's actions that aligned pay-for-performance during the recession; (2) the CEO's pay increased only 6.4% since 2007, the last year in which he received a bonus; (3) ISS' valuation of the CEO's 2010 time-based stock option grant significantly overstated his total compensation and (4) ISS' model to value stock options differs from GE's model and is inconsistent with applicable accounting guidelines. (GE filed this communication as an additional proxy material with the Securities and Exchange Commission.)

Subsequently, on April 18, 2011 one week prior to the annual shareholder meeting, GE announced that after conversations with certain unnamed

shareholders, it had modified the CEO's 2010 time-based stock option grant such that it would vest only upon the achievement of certain cash flow and stock performance targets. GE's CEO agreed to this modification. Likewise, GE reiterated that in 2011 it will resume the practice of granting only performance-based equity awards to its CEO. (Again, GE filed this communication as an additional proxy material with the SEC.)

GE's imposition of performance conditions on the CEO's 2010 stock option worked. It swayed ISS to change its recommendation to support GE's Say-on-Pay proposal. Plus, GE's Say-on-Pay proposal passed with (what we understand to be) 85% of the votes at the April 27th annual shareholder meeting.

Take-Away

Companies should be mindful of the important role that ISS plays with respect to Say-on-Pay proposals and of the weight that it places on pay-for-performance. Nevertheless, the GE experience illustrates how ISS encourages companies to take actions that it deems are in the best interests of shareholders. ISS will consider changing its voting recommendation if a company takes actions to address concerns raised in ISS' analysis and recommendation, discloses such actions in a filing with the SEC and if the shareholder meeting is at least five business days away.

For more information, you may contact any attorney in the *Executive Compensation and Employee Benefits Group*.

©2011 FENWICK & WEST LLP. ALL RIGHTS RESERVED.

THE VIEWS EXPRESSED IN THIS PUBLICATION ARE SOLELY THOSE OF THE AUTHOR, AND DO NOT NECESSARILY REFLECT THE VIEWS OF FENWICK & WEST LLP OR ITS CLIENTS. THE CONTENT OF THE PUBLICATION ("CONTENT") IS NOT OFFERED AS LEGAL SHOULD NOT BE REGARDED AS ADVERTISING, SOLICITATION, LEGAL ADVICE OR ANY OTHER ADVICE ON ANY PARTICULAR MATTER. THE PUBLICATION OF ANY CONTENT IS NOT INTENDED TO CREATE AND DOES NOT CONSTITUTE AN ATTORNEY-CLIENT RELATIONSHIP BETWEEN YOU AND FENWICK & WEST LLP. YOU SHOULD NOT ACT OR REFRAIN FROM ACTING ON THE BASIS OF ANY CONTENT INCLUDED IN THE PUBLICATION WITHOUT SEEKING THE APPROPRIATE LEGAL OR PROFESSIONAL ADVICE ON THE PARTICULAR FACTS AND CIRCUMSTANCES AT ISSUE.

IRS CIRCULAR 230 DISCLOSURE: TO ENSURE COMPLIANCE WITH REQUIREMENTS IMPOSED BY THE IRS, WE INFORM YOU THAT ANY U.S. FEDERAL TAX ADVICE IN THIS COMMUNICATION (INCLUDING ATTACHMENTS) IS NOT INTENDED OR WRITTEN BY FENWICK & WEST LLP TO BE USED, AND CANNOT BE USED, FOR THE PURPOSE OF (I) AVOIDING PENALTIES UNDER THE INTERNAL REVENUE CODE OR (II) PROMOTING, MARKETING, OR RECOMMENDING TO ANOTHER PARTY ANY TRANSACTION OR MATTER ADDRESSED HEREIN.