King & Spalding

Public Company Advisor

Practical Insights for Public Company Counsel

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King & Spalding's Public Company Practice Group periodically publishes the Public Company Advisor *to provide practical insights into current corporate governance, securities compliance and other topics of interest to public company counsel.*

2012 Proxy Season Update

As the 2012 proxy season draws to a close, it is never too early for companies to begin considering lessons from this year's results and planning for 2013. In this edition of the *Public Company Advisor*, we provide an overview of the key results of the 2012 proxy season—including say on pay votes, significant shareholder proposals, director elections and emerging best practices in drafting proxy statements—as well as practical advice for planning for 2013.

Say on Pay

2012 Results

The 2012 proxy season marked the second year of required "say on pay" votes at public companies. Continuing the trend from 2011, say on pay votes this year have been overwhelmingly positive. Average shareholder support in 2012 (through June 15, 2012) was 91% (versus 92% in 2011). Approximately 52 companies have failed to achieve majority support for say on pay, which slightly exceeds the number from all of 2011.

In addition, most companies that lost a say on pay vote in 2011 have received strong shareholder approval for say on pay in 2012. As of June 15, 2012, of the 26 companies that had failed votes in 2011 and had reported the results of their 2012 annual meetings, 23 companies received shareholder approval, and 14 of those companies received support in excess of 90%. In many cases, these companies implemented changes to their compensation policies and practices in response to the concerns that generated the prior negative votes and clearly disclosed these changes in their 2012 proxy statements.

Proxy advisory firms, such as ISS and Glass Lewis, continued to significantly influence say on pay votes in 2012. Through the first half of the 2012 proxy season, S&P 500 companies receiving a positive ISS recommendation garnered average support of 94% for say on pay, while companies receiving a negative recommendation received only 61% support. Of the companies receiving negative ISS recommendations, 16% ultimately lost the vote.

Practical Advice for 2013

Looking forward to 2013, companies should be encouraged by the second year of generally positive results on say on pay; however, companies should continue to consider strategies for improving support for say on pay, such as the following:

- Reach out to shareholders well in advance of the 2013 proxy season (especially any shareholders who may have voted against say on pay this year) to understand any concerns that may affect their votes.

- Analyze the company's shareholder base to understand which shareholders follow ISS and/or Glass Lewis, and the potential impact of a negative recommendation from these proxy advisory firms.

- Evaluate compensation programs through the lens of the proxy advisory firms' say on pay voting policies (especially pay-for-performance disconnects or problematic pay practices) and consider adopting changes to address these and/or shareholder concerns.

- Ensure that the compensation disclosure in the 2013 proxy statement clearly describes steps taken to address compensation concerns.

- Approach the Compensation Discussion & Analysis in the 2013 proxy statement as a work of advocacy for the say on pay vote, rather than merely a description of compensation practices.

In addition, companies should be prepared to react quickly in the event of a negative proxy advisor recommendation and should consider the following approaches:

- Companies can engage directly with ISS in an attempt to change ISS's recommendation. This strategy can be successful if a company agrees to make compensation changes in advance of its annual meeting.

- Companies also can consult directly with their significant shareholders to make the case for supporting say on pay, notwithstanding a proxy advisor's negative recommendation. Many institutional shareholders take proxy advisors' recommendations into account, but ultimately make their own voting decisions. Further, a proxy advisor's analysis will often ignore or minimize certain factors or circumstances that a company can point out to shareholders to support its pay practices.

- Finally, companies can take a more aggressive approach and attempt to publicly rebut a proxy advisor's recommendation by directly communicating with shareholders through use of additional soliciting materials that are also filed with the Securities and Exchange Commission (SEC). This approach was employed by a growing number of companies that received negative recommendations in 2012.

Shareholder Proposals

Proxy Access

The SEC allowed shareholders to submit proposals for the 2012 proxy season regarding adoption of "proxy access," a process whereby shareholders owning a specified percentage of a company's stock for a specified time period can nominate directors for inclusion in a company's proxy statement. This development, which we covered in the November 2011 edition of the *Public Company Advisor*,[1] followed a court ruling striking down mandatory proxy access rules that had been adopted by the SEC. More than 20 companies received proxy access proposals for the 2012 proxy season, although many proposals were excluded on technical grounds or after negotiation. As of June 15, 2012, nine proposals had come to a vote. Overall, proxy access proposals received only moderate shareholder support (on average, approximately 35%); however, at two companies—Nabors Industries and Chesapeake Energy—proxy access proposals passed with a majority vote. In both cases, the proposals requested proxy access for shareholders holding 3% of outstanding shares for three years—the same threshold originally adopted by the SEC. Looking forward to 2013, companies—especially those dealing with shareholder discontent—should be prepared for the possibility of proxy access proposals from shareholders.

Corporate Political Contributions

The 2012 proxy season also saw a significant increase in shareholder proposals related to corporate political spending and lobbying activities. These proposals generally sought disclosure of corporate political contributions or lobbying expenses—ranging from a report of the procedures companies follow in making these contributions or expenditures to a specific report identifying company employees who approved each contribution or expenditure. Even some companies that have not made direct political contributions or directly incurred lobbying expenses received these shareholder proposals. In these cases, shareholders asked for reports on contributions to trade associations that lobbied on companies' behalf, including in some cases reports on the risks and responsibilities of supporting these associations. While one company recently received a majority vote in favor of a corporate political contributions proposal, in general shareholder support for these proposals remains low (on average, less than 30%). Nevertheless, in light of the increased prevalence of these proposals, companies that are involved (directly or indirectly) in lobbying or making political contributions, or that support trade associations, should be prepared for the possibility of a shareholder proposal in 2013.

Director Elections

Despite a few targeted "vote no" campaigns, support for board nominees during the 2012 proxy season generally equaled or surpassed 2011 results. ISS recommended a withhold or against vote for only approximately 3% of director nominees at S&P 500 companies in 2012. Of these directors who received a negative recommendation, only approximately 9% failed to receive a majority vote. This result continues a trend of decreasing opposition for director candidates over the past several years. Increasing investor focus on say on pay votes and shareholder proposals appears to have provided an outlet for discontent that, in prior years, may have been manifested through withhold campaigns against directors.

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[1] http://www.kslaw.com/library/publication/PublicCompanyAdvisor-Nov2011.pdf

Proxy Drafting

Companies' 2012 proxy statements continued a trend from 2011 of increased use of executive summaries. In an attempt to make their proxy statements more user-friendly for shareholders, companies placed "proxy summaries" at the beginning of the proxy statement and/or "CD&A summaries" at the beginning of the Compensation Discussion & Analysis section. A proxy summary generally provides an overview of the matters to be voted on and directs shareholders to the more detailed information in the full proxy statement. Similarly, a CD&A summary typically provides a brief description of a company's compensation philosophy and a bullet point summary of the key compensation decisions or developments during the prior year. Companies should consider employing a proxy summary and a CD&A summary in their proxy statements for 2013, as well as other measures that will make the proxy statement easier to navigate and understand.

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King & Spalding's Public Company Practice Group is a leader in advising public companies and their boards of directors in all aspects of corporate governance, securities offerings, mergers and acquisitions and regulatory compliance and disclosure.

About King & Spalding

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