

What's New for the 2012 Proxy Season

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Rather than a host of new disclosure requirements, companies this proxy season are facing heightened scrutiny by investors and proxy advisors of pay-performance alignment, the threat of shareholder lawsuits over failed say-on-pay votes, and shareholder proposals seeking proxy access. In order to best tackle these new challenges, companies should revisit the lessons learned from their first year of mandatory say-on-pay voting, assess whether their 2011 compensation programs present any new issues warranting company action, engage with investors and proxy advisors regarding lingering compensation concerns and present the pay and performance linkages in the CD&A in a clear and convincing fashion. In addition, while delays in SEC rulemaking have postponed inclusion in the proxy statement of the remaining Dodd-Frank corporate governance and executive compensation disclosure items, consideration should be given as to how those new disclosure items might impact the CD&A in the 2013 proxy season.

Say-on-Pay and Say-on-Frequency

Looking Back at the 2011 Proxy Season. As required under Dodd-Frank, last year many companies included in their proxy statements say-on-pay and say-on-frequency proposals for the first time. Pursuant to these proposals, shareholders were asked to vote, on a nonbinding basis, on the compensation of the company's named executive officers and on the frequency with which such votes would take place in the future. Despite all of the anxiety generated by the say-on-pay proposals, 98 percent of companies received majority support from their shareholders on the say-on-pay proposal, and average approval was around 90 percent. Companies that failed to garner majority support on the say-on-pay proposal were viewed by investors as having a disconnect between pay and performance or other "problematic" pay practices. When voting on the say-on-frequency proposal last year, shareholders most often supported an annual say-on-pay vote.

The inclusion of say-on-pay proposals in proxy statements last year affected the proxy season in a variety of ways. Many companies significantly increased their engagement efforts with shareholders, and some companies made immediate changes to their pay practices in order to increase shareholder support. More than 70 companies faced with negative voting recommendations from proxy advisory firms submitted supplemental materials taking issue with the recommendations and clarifying for their investors their company's pay practices. As expected, the say-on-pay proposals provided an alternative method for shareholders to voice disapproval of executive compensation and, as a result, the number of compensation committee members failing to receive majority support declined significantly. Lastly, some of the relatively few companies that failed to receive

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majority support for their say-on-pay proposals became the target of shareholder litigation based on such voting results.

Looking Forward to the 2012 Proxy Season. Because most companies are following shareholder preference to conduct say-on-pay votes annually, say-on-pay proposals will be included in many proxy statements again this year. While many commentators anticipate that companies which received less than 70 percent support for their say-on-pay proposals will face heightened scrutiny this year, all companies should take the actions described below in order to ensure that they will continue to receive significant support for future say-on-pay proposals.

Dissect Voting Results from 2011 and Engage with Investors and Proxy Advisors.

A first step companies should take in preparing for this year's say-on-pay vote is to reach out to the larger shareholders that voted against the company's say-on-pay proposal in 2011 in order to understand why the shareholders expressed disapproval of the compensation program. After learning about the specific areas of concern, companies should consider changing those areas of the compensation program or offering a better explanation in the proxy materials or in supplemental disclosure for their program structure. Similarly, companies should make contact with proxy advisory firms that recommended voting against the compensation program last year to clarify any issues that were misunderstood in the prior year and to discuss any new issues anticipated for the 2012 vote. As discussed below, actions taken by companies in addressing last year's say-on-pay vote must be disclosed in the CD&A section of the proxy statement this year.

Revisit Problematic Pay Practices and GRId Ratings. As in prior years, companies should consider whether they can do away with compensation arrangements characterized by investors or proxy advisory firms as "problematic" pay practices (e.g., excise tax gross-ups, single-trigger change in control provisions, excessive perquisites and gross-ups on perquisites). In addition, companies may find it useful to review the compensation-related questions recently added to the Institutional Shareholder Services Inc. ("ISS") updated GRId ratings to be launched in February 2012 (<http://www.issgovernance.com/grid-info>).

Analyze Alignment of Pay and Performance in 2011 Compensation Program. In December 2011, ISS published a white paper providing a detailed discussion and explanation of its new approach to evaluating pay-for-performance in 2012. Using a narrower peer group, ISS will look at the relative pay rank of the CEO compared to total shareholder return for the peer group over a one year and three year period, as well as the multiple of CEO pay compared to the peer group median. The other part of ISS's quantitative review will be company-specific and will focus on the rate of change in annual pay compared to the rate of change in total shareholder return over a five year period. Following this assessment, ISS may conduct a qualitative review to determine either the cause of any perceived long-term disconnect between pay and performance or factors that mitigate the initial assessment. Companies should become familiar with ISS's new approach to evaluating the relationship between pay and performance and analyze how the company's compensation aligns with performance under the new metrics. The ISS white paper is available at:

<http://www.issgovernance.com/docs/EvaluatingPayForPerformance2012>.

Review, Update and Enhance Proxy Disclosure. Pursuant to Item 402(b)(1)(vii) of Regulation S-K, companies are required to include disclosure in the CD&A this year regarding whether and how the company considered the results of the most recent say-on-pay vote in determining compensation policies and decisions and how that consideration affected the company's executive compensation decisions

and policies. This disclosure is the only new disclosure requirement for 2012 and is required even if a say-on-pay vote is not being conducted this year. A company that failed to receive meaningful support for its prior say-on-pay proposal will want to include disclosure regarding its response to the vote, including outreach efforts to large institutional investors and specific actions taken to address the compensation issues that led to shareholder disapproval. In preparing the CD&A this year, companies should also specifically review the pay-for-performance disclosure, including the discussion regarding performance metrics, to ensure that it is accurate, clear and complete.

Say-on-Frequency. Because Dodd-Frank only requires say-on-frequency votes to be conducted at least once every six years, it is unlikely that many say-on-frequency proposals will be included voluntarily by companies in their proxy statements this season.

Proxy Access

In August 2010, the SEC adopted the mandatory proxy access rule, Rule 14a-11, which would have required public companies to permit shareholders owning at least three percent of a public company's voting stock for at least three years to include director nominees in company proxy materials. At the time it adopted Rule 14a-11, the SEC also adopted amendments to Rule 14a-8 that would allow shareholders to include proxy access proposals in company proxy materials. In September 2010, the Business Roundtable and U.S. Chamber of Commerce filed a lawsuit challenging Rule 14a-11, and as a result of that suit, the SEC voluntarily stayed effectiveness of both Rule 14a-11 and the amendments to Rule 14a-8. In July 2011, the U.S. Court of Appeals for the District of Columbia Circuit vacated Rule 14a-11, and the SEC announced in September 2011 that it would not appeal the case, thereby taking mandatory proxy access off the table. The Rule 14a-8 amendments, however, did go into effect in September 2011, allowing companies and their shareholders to adopt proxy access procedures through the shareholder proposal process. To date, more than a dozen proxy access proposals have been submitted by shareholders for the 2012 proxy season, and we expect that number to increase significantly.

Shareholder Proposals

Trends in 2011 Proxy Season. Because Dodd-Frank addressed many of the compensation-related concerns of shareholder activists (e.g., mandatory say-on-pay votes, advisory votes on golden parachutes and mandatory clawback policies), fewer shareholder proposals were submitted in 2011 than in the prior year. In addition, increased shareholder engagement and increased willingness by companies to make changes to governance practices also contributed to the decline in shareholder proposals last year. The 2011 U.S. Postseason Report issued by ISS (<http://www.issgovernance.com/docs/2011USPostseason>) provides useful information regarding the 2011 shareholder proposal trends, including the following:

- Shareholder proposals seeking board declassification averaged 73.5 percent support in 2011, an increase of more than 12 percentage points from 2010, and won majority support at 22 out of 23 large-cap companies.
- At least 35 majority voting proposals were withdrawn by proponents after companies agreed to adopt the voting standard, and average support for the proposals submitted for a shareholder vote was 59 percent.
- Independent board chair proposals won majority support at four companies.

- There were fewer shareholder proposals to repeal supermajority rules as more management proposals on this topic were submitted to a shareholder vote.
- Average investor support for shareholder proposals on environmental and social (“E&S”) issues increased to 20.6 percent, and five E&S proposals received majority support, which is a new record for E&S proposals.

Expectations for 2012 Proxy Season. As noted above, proxy access procedures are expected to be a hot topic for shareholder proposals this proxy season. In addition, because it is an election year, many are expecting to see more shareholder proposals regarding disclosure of political contributions. Mid and small-cap companies are expected to be the target of majority voting proposals, and support for E&S proposals will likely continue to increase.

Review Staff Legal Bulletin No. 14F. Companies that receive shareholder proposals this year should remember to review Staff Legal Bulletin No. 14F, which was issued in October 2011 and is available at

<http://www.sec.gov/interp/leg/cfs14f.htm>. The bulletin contains information regarding brokers and banks that constitute “record” holders eligible to submit Rule 14a-8 proposals, the submission of revised proposals by proponents, the procedures for withdrawing no-action requests relating to proposals submitted by multiple proponents and the SEC’s new process for transmitting Rule 14a-8 no-action responses by email.

2012 Proxy Voting Policies

ISS 2012 Voting Policy Updates. In November 2011, ISS published its 2012 U.S. Corporate Governance Policy updates, which will be effective for shareholder meetings held on or after February 1, 2012. In addition to changing its approach to assessing performance-pay alignment as noted above, ISS updated other voting policies of interest for the upcoming proxy season. These updated voting policies are summarized below. To review all of ISS’s updated policies, go to http://www.issgovernance.com/policy/2012/policy_information.

Board Response to High Levels of Say-on-Pay Opposition. If a company’s previous say-on-pay proposal received the support of less than 70 percent of votes cast, ISS will take a closer look at the company’s election of compensation committee members and say-on-pay proposals for 2012. ISS will evaluate these proposals on a case-by-case basis taking into account multiple factors, including: the company’s response to the say-on-pay vote, including the company’s disclosure of engagement efforts with investors and actions taken to address the issues of concern to investors, whether the issues raised were recurring issues, the company’s ownership structure and the percentage of support received in the prior vote.

Board Response to Say-on-Frequency Vote Results. If the board implements a say-on-pay vote on a less frequent basis than the frequency which received the majority of votes cast in the most recent say-on-frequency vote, ISS will recommend against or withhold from the entire board (except new nominees, who will be considered on a case-by-case basis). If the board implements an option that is less frequent than that which received a plurality of votes cast, then ISS will make a vote recommendation on a case-by-case basis taking into account the board’s rationale for implementing a less frequent say-on-pay vote, the company’s ownership structure, compensation concerns, and the say-on-pay support level from the prior year.

Proxy Access Proposals. ISS’s voting recommendations regarding proxy access

shareholder proposals will continue to be determined on a case-by-case basis but will take into account additional factors, including the ownership thresholds proposed in the shareholder proposal, the maximum number of directors that shareholders may nominate each year, and the method of determining which nominations should appear on the ballot if multiple shareholders submit nominations. ISS has indicated that it expects to provide additional guidance regarding proxy access proposals sometime this month.

Political Spending Proposals. ISS changed its voting policy for 2012 for shareholder proposals seeking disclosure of political contributions and will now generally vote for these proposals rather than on a case-by-case basis.

Other Voting Policies. While Glass Lewis & Co. has not yet released its full set of proxy voting guidelines for the 2012 proxy season, it has indicated its policy to apply heightened scrutiny to companies that received more than 25% of votes against say-on-pay proposals in 2011. Companies should review the updated guidelines when they are posted to the Glass Lewis website (<http://www.glasslewis.com/solutions/proxypaper.php>). Lastly, companies should make sure they are familiar with the voting policies of their large institutional investors.

Timeline of Other Dodd-Frank Corporate Governance and Executive Compensation Items

The SEC has struggled to keep up with the rulemaking mandated by Dodd-Frank and has repeatedly pushed back the timeline for proposing and adopting the remaining corporate governance and executive compensation items under Dodd-Frank. The current timeline for these items as set forth on the SEC's website is described below.

Requirement	Timing of SEC Rulemaking	Next Steps
<ul style="list-style-type: none"> • Compensation Committees be comprised solely of independent directors 	<ul style="list-style-type: none"> • Proposed rules issued March 2011 • Final rules expected by June 2012 	<ul style="list-style-type: none"> • Review independence of current directors • Review related provisions of corporate governance guidelines and Board committee charters
<ul style="list-style-type: none"> • Compensation Committees consider the independence of advisers (including compensation consultants and legal advisers) based on factors identified by the SEC • Disclosure in proxy statement regarding retention of compensation consultant and any conflicts of interest with the 	<ul style="list-style-type: none"> • Proposed rules issued March 2011 • Final rules expected by June 2012 	<ul style="list-style-type: none"> • Review independence of current adviser • Review related provisions of corporate governance guidelines and Board committee charters • Consider proxy disclosure regarding conflicts of interest • Implement controls and procedures

consultant.		
<ul style="list-style-type: none"> • Disclosure in proxy statement regarding the median of employee pay and the ratio of that amount to the CEO's pay 	<ul style="list-style-type: none"> • Proposed rules expected by June 2012 • Final rules expected between July – December 2012 	<ul style="list-style-type: none"> • Consider how to compute median for all employees • Estimate ratio of CEO to all employees and assess shareholder reaction
<ul style="list-style-type: none"> • Disclosure in proxy statement regarding how executive pay compares to the company's performance 	<ul style="list-style-type: none"> • Proposed rules expected by June 2012 • Final rules expected between July – December 2012 	<ul style="list-style-type: none"> • Review current pay and performance linkages and compare to peers • Review CD&A to confirm the relationship between actual pay and performance is clear and convincing to shareholders
<ul style="list-style-type: none"> • Disclosure in proxy statement whether company has hedging policy for directors and employees 	<ul style="list-style-type: none"> • Proposed rules expected by June 2012 • Final rules expected between July – December 2012 	<ul style="list-style-type: none"> • Consider modifying existing hedging policy or adopting a new hedging policy • Consider adding disclosure to proxy statement regarding the modification or adoption of a hedging policy
<ul style="list-style-type: none"> • Adoption of clawback policy consistent with the rule requirements • Disclosures in proxy statement regarding clawback policy 	<ul style="list-style-type: none"> • Proposed rules expected by June 2012 • Final rules expected between July – December 2012 	<ul style="list-style-type: none"> • Review existing clawback policy against the requirements of Section 10D or consider adopting a clawback policy • Determine how the proxy disclosure regarding the policy may need to be revised

As the CD&A section of the proxy statement is revised this year, proxy drafters should keep in mind how these remaining disclosure items will be incorporated into the CD&A next year.

Other SEC Reporting Items to Consider this Proxy Season

The other new items that companies should consider when preparing SEC disclosure documents this proxy season are summarized below.

Interpretive Guidance on Cybersecurity Disclosures. In October 2011, the SEC issued interpretive guidance to assist companies in assessing what, if any, disclosures should be provided in periodic reports and registration statements about cybersecurity matters. The new guidance does not change any of the existing disclosure requirements but provides a useful reminder to companies that cybersecurity matters may require disclosures in a company's risk factor, MD&A, business description, legal proceedings, and disclosure controls and

procedures sections of periodic reports and could warrant Form 8-K disclosure as well. (See the Dorsey & Whitney LLP Corporate Update dated October 20, 2011, available at http://www.dorsey.com/eu_corporate_cybersecurity_102011.)

Mine Safety and “Conflict Minerals” Disclosures. In December 2011, the SEC adopted final rules requiring mining companies to include information about mine safety and health in the quarterly and annual reports they file with the SEC. (See SEC Release No. 33-9286, which is available at <http://www.sec.gov/rules/final/2011/33-9286.pdf>.) Mining companies are also required to file current reports on Form 8-K upon receipt of certain orders and notices from the Mine Safety and Health Administration. Although the SEC issued proposed rules in December 2010 regarding disclosure of the use of “conflict minerals” that originated in the Democratic Republic of the Congo and surrounding countries, there has been strong resistance to the disclosure requirements and no final rules have been adopted by the SEC.

Other Disclosure Enhancements. As emphasized in published guidance, speeches and comment letters, the staff of the SEC continues to look for greater disclosure in certain areas, including liquidity, exposure to European debt and foreign currency exchange, loss contingencies, environmental liabilities, global warming and multi-employer pension plans.

Updated Compliance and Disclosure Interpretations. Throughout 2011, the SEC updated its Compliance and Disclosure Interpretations (“C&DIs”) relating to Regulation S-K and Exchange Act rules and forms. The updated C&DIs are available at <http://www.sec.gov/divisions/corpfin/cfguidance.shtml> and, as always, should be consulted when preparing disclosures for proxy statements and other SEC filings.

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