An Early Look at the 2011 Proxy Season

February 24, 2011 by Yonat Assayag and Russell Miller

With the 2011 proxy season underway, the early returns are in: Among the first 30 *Fortune* 500 companies to file proxies, an analysis finds the focus to be on eliminating "hot" shareholder issues such as tax gross-ups and enhancement of shareholder alignment through tools such as ownership guidelines, anti-hedging policies and improved disclosure to ensure shareholders make an informed vote.

These first 30 companies range from $5 billion to $125 billion in revenue and span a variety of industries.

New federal regulations under the Dodd-Frank Act require companies to hold non-binding shareholder votes on their executive pay programs (say on pay), the frequency of future say-on-pay votes (say on frequency), and golden parachute payments in the event of a transaction (say-on-golden parachutes). The say-on-pay and say-on-frequency votes are required for all publicly-traded companies with annual shareholder meetings held after January 21, 2011. The say-on-golden-parachutes requirement is effective April 4, 2011. Smaller reporting companies (less than $75 million in public float) are granted a two-year delay until these votes are effective.

As boards consider implications of these advisory votes, they no doubt are wondering what other companies are doing in light of say on pay. Are companies "staying the course" and letting the chips fall as they may, or are they proactively modifying their executive pay programs and/or disclosure in an attempt to secure majority support from shareholders?

Program Changes

In 2010, companies sought to minimize shareholder distractions and improve the pay/performance relationship and shareholder alignment:

- Ashland Inc., Johnson Controls and six other companies eliminated excise tax gross-ups
- Of 20 companies disclosing clawback provisions for their named executive officers, 10 adopted these provisions recently. For example, Franklin Resources and Visa implemented clawback provisions in 2010
- While CEO stock ownership guidelines of 5x salary is most common among *Fortune* 500 companies, two companies (Qualcomm and Agilent Technologies) increased their guidelines from 5x to 6x salary, possibly in response to Institutional Shareholder Services' (ISS) preference
- 18 companies disclosed an anti-hedging policy prohibiting executives from using hedging vehicles against the company's stock, compared to 11 companies in 2009

Disclosure Changes

There was a noticeable shift in the approach to the Compensation Discussion & Analysis (CD&A) section of the proxy statement among the First 30. CD&As are being treated less as a compliance exercise and more as a tool for effectively communicating with shareholders about the decisions and rationale behind the executive pay program. CD&As among the First 30 made information more accessible to the reader:

- Prevalence of executive summaries more than doubled, from nine companies last year to 20 companies this year. Executive summaries highlighted company performance, pay-and-performance alignment, and any key changes to the compensation program
- Companies used more charts and graphs to describe their pay programs and illustrate pay-performance relationships in a user-friendly way. Deere & Co., for example, included a chart in its proxy statement plotting the CEO's and other named executive officers' three-year total "realizable" compensation relative to peers vs. relative total shareholder return over the same three-year period.
- In addition, all of the First 30 companies discussed pay versus performance in some way in their CD&A and nine disclosed the information graphically. This level of disclosure may be a preview to the pending pay/performance disclosure requirement under Dodd-Frank, which won't likely be be effective until 2012.

Say-on-Pay and Say-on-Frequency Resolutions

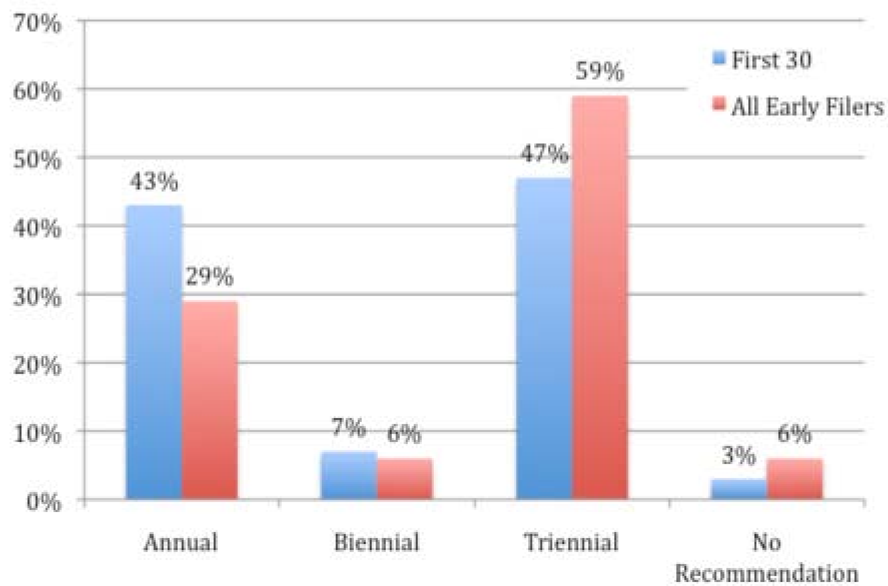
Given that the SEC did not specify a form of resolution for the shareholder votes, companies took a wide range of approaches in preparing their resolutions. Say-on-pay resolutions ranged from a brief description of the vote with reference to the CD&A (an approach taken by Hewlett Packard, Starbucks and Walt Disney) to a multi-page analysis of the objectives of the compensation program, the pay-for-performance relationship and key features. The most common approach (18 companies) was somewhere between these two extremes, where the company provided a one-page supporting statement reminding shareholders of the key elements of the program (similar to an executive summary).

Say-on-frequency asks shareholders to vote among four choices: annual, biennial, triennial, or abstain. Boards have the option to include their frequency recommendation.

- Nearly all say-on-frequency proposals among the First 30 included a board recommendation
- Annual and triennial vote recommendations were most common among the First 30, with triennial (at 47%) slightly more common than annual (at 43%)
- Interestingly, among the more than 200 companies that have filed proxies early, twice as many recommended triennial compared to annual votes

Given the early vote results (see below) and indications from shareholders and advisory groups, it would not be surprising for the number of annual recommendations to increase.

- ISS has indicated they will recommend votes for annual say-on-pay
- A group of 39 institutional investors, collectively holding $830 billion in assets, issued a press release urging companies to recommend an annual frequency
- Major mutual funds, including Vanguard, State Street, Fidelity and Putnam, have indicated that they will support annual frequency



Early Vote Results

Early in 2011, voting results for eleven of the First 30 companies were in. Only one company (Jacobs Engineering) did not receive majority shareholder support of their executive compensation program, receiving 45% favorable votes to 55% against votes (note: although not a *Fortune* 500 company, Beazer Homes USA also did not receive majority shareholder support with 54% voting “against”). Among the ten companies receiving majority support on say-on-pay, 89% of shareholders, on average, voted in support of executive pay programs.

Board frequency recommendations did influence some voters, but did not sway shareholders overall. Shareholders have a clear preference for annual say-on-pay, as is evidenced by the fact that all the companies recommending a triennial vote received majority support for annual. Hormel Foods, one of the few companies to recommend a biennial vote, received majority support from shareholders for the biennial proposal. The shareholders of Becton Dickinson indicated their preference that the advisory vote be held annually, given no recommendation by the board.

	Say-on-Pay Vote		Say-on-Frequency Vote			
Company	**FOR**	**AGAINST**	**Board Recomm.**	**Annual**	**Biennial**	**Triennial**
Ashland	**95%**	5%	Triennial	**68%**	2%	30%
Air Products & Chemicals	**85%**	15%	Triennial	**61%**	1%	39%
Becton Dickinson & Co	**96%**	4%	None	**84%**	3%	13%
Costco Wholesale	**99%**	1%	Triennial	**53%**	4%	44%
Emerson Electric Co	**96%**	4%	Triennial	**57%**	2%	41%
Hormel Foods Corp	**99%**	1%	Biennial	25%	**72%**	3%
Jacobs Engineering	45%	**55%**	Triennial	**68%**	3%	29%
Johnson Controls Inc	**62%**	38%	Triennial	**59%**	2%	40%
Monsanto	**66%**	34%	Triennial	**63%**	1%	36%
Oshkosh Corp	**95%**	5%	Annual	**89%**	1%	10%
Visa	**98%**	2%	Annual	**88%**	0%	11%

Note: Votes are as a percentage of votes cast (exclude abstentions and broker non-votes)
***Bold** indicates majority shareholder support*

Conclusion

As companies continue to prepare for their upcoming say-on-pay vote, it is important to understand how shareholders will view the compensation program and ensure disclosure clearly communicates the design and business rationale. While data on the First 30 may help inform companies as they prepare for say-on-pay, each company's specific business needs should ultimately drive compensation decisions.

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http://www.directorship.com/say-on-pay-an-early-look-at-the-2011-proxy-season/