CAPflash
Compensation Advisory Partners Newsletter | Issue #19 | May 26, 2011

2011 Proxy Season Updates—Say on Pay and New Fidelity Voting Guidelines

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As of May 20, 2011, 290 S&P 500 companies have reported vote results following their 2011 annual meetings, providing early insight into Say on Pay and frequency-related votes from this proxy season.

In addition, Fidelity, one of the largest institutional investors, recently released new proxy voting guidelines effective for 2011, impacting vote results for many companies during this proxy season and beyond.

Say on Pay Update

On January 25, 2011, the SEC issued final rules implementing Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), which generally provides shareholders of US public companies with the right to cast three types of advisory votes related to executive compensation:

1. A vote to approve the compensation of the Named Executive Officers (NEOs), effective for shareholder meetings occurring on or after January 21, 2011;

2. A vote on the frequency with which shareholders should be entitled to cast Say on Pay votes (every one, two or three years), effective for shareholder meetings occurring on or after January 21, 2011; and

3. A vote on golden parachute arrangements for NEOs related to a sale, consolidation or merger, effective April 25th, 2011.

To date, 419 of the S&P 500 companies included Say on Pay resolutions in either a preliminary or definitive proxy statement. Vote results from annual meetings are available for 290 of these companies.

> ***CAP Comment:*** *While these votes are non-binding, we expect that most companies will carefully evaluate their vote results, taking some action if there is low shareholder support (not just in the limited cases where a majority of shareholders did not support the company's executive compensation program).*

Say on Pay Frequency Vote Results

An annual vote frequency is emerging as the clear shareholder preference. Among 94% of S&P 500 companies reporting vote results, a majority of shareholders supported annual Say on Pay vote frequency. This differs from vote recommendations, where only 67% of the companies had recommended an annual vote.

Company Recommendation (n=419)

Vote Frequency	# of Companies	% of Companies
Annual	281	67%
Biennial	13	3%
Triennial	108	26%
No Recommendation	17	4%

Vote Results: Received Majority Shareholder Support (n=290)

Vote Frequency	# of Companies	% of Companies
Annual	272	94%
Biennial	1	0%
Triennial	12	4%
None (only plurality)*	5	2%

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The strong support for annual votes is not a surprise. 39 institutional investors, representing more than $830 billion in assets, issued a public call for companies and investors to support annual advisory votes on executive compensation in 2011 proxy statements. Similarly, a number of major mutual funds have also indicated support for the annual Say on Pay votes, and ISS' policy recommends that shareholders support annual votes (Glass Lewis has indicated a similar preference)[i].

> ***CAP Comment:*** *As the 2011 proxy season continues, we expect the prevalence of annual vote frequency recommendations to increase.*

> ***CAP Comment:*** *Following the frequency vote, the SEC rules mandate disclosure through an 8-K of how often the company will hold future Say on Pay votes[ii]. Issuers must also provide proxy-based disclosure of the current frequency of Say on Pay votes and when the next scheduled Say on Pay vote will occur.*

> ***CAP Comment:*** *When companies conduct their Say on Pay vote in line with the frequency preferred by a majority of shareholders, they may exclude shareholder frequency proposals from the proxy for six years.*

Say on Pay Vote Results

Say on Pay resolutions received majority shareholder support at all but five S&P 500 companies, with support ranging from 55% to 100%[iii]. The five companies where a majority of shareholders did not support the executive compensation program were Hewlett-Packard, Jacobs Engineering, Janus Capital Group, Masco Corp. and Stanley Black & Decker.

% in Favor	# of Companies	% of Companies
90% - 100%	192	66%
80% - 90%	43	15%
70% - 80%	26	9%
50% - 70%	24	8%
0% - 50%	5	2%

> ***CAP Comment:*** *While a company does not "fail" its Say on Pay vote unless a majority of shareholders vote against the compensation program, an "acceptable" shareholder support threshold is likely to emerge. To-date, results indicate this threshold will be around 80% shareholder support.*

> ***CAP Comment:*** *The final SEC rules require additional disclosure in the CD&A regarding whether, and if so how, companies have considered the results of the most recent Say on Pay vote.*

Some notable companies have been proactive during this proxy season, filing supplementary soliciting materials. Select examples include: General Electric, Disney, ExxonMobil, Johnson & Johnson, Hewlett-Packard, and Northern Trust. While these filings were generally in reaction to negative vote recommendations from shareholder advisory services such as ISS, ExxonMobil went a step further by filing supplementary materials (essentially an executive pay brochure) on the same day as the proxy. ExxonMobil still received a negative vote recommendation from ISS, and later filed additional soliciting material rebutting ISS' vote recommendation.

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i For additional detail, see 12/5/10 CAPFlash: "ISS 2011 Policy Updates – Here Comes Say on Pay."

ii Required no later than 150 calendar days after the date of the annual meeting in which the vote took place, but in any event no later than 60 calendar days prior to the deadline for submission of Rule 14a-8 shareholder proposals for the subsequent annual meeting.

iii Outside of the S&P 500, an additional 18 companies did not receive majority shareholder support for their NEO compensation program (as of 5/20/11): Ameron International, Beazer Homes, Cincinnati Bell, Cogent Communications, Curtiss-Wright, Dex One Corporation, Helix Energy Solutions, Hercules Offshore, Intersil Corp., M.D.C. Holdings, Navigant Consulting, NutriSystem, NVR, Inc., Penn Virginia Corporation, PICO Holdings, Shuffle Master, Stewart Information Services Corporation and Umpqua Holdings Corporation.

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New Fidelity Compensation-Related Voting Guidelines

Fidelity recently released revised proxy voting guidelines that are effective immediately[iv]. Our discussion below focuses on guidelines for Say on Pay proposals and new share requests[v].

Say on Pay Proposals

Fidelity will generally vote for proposals to approve executive compensation unless such compensation is misaligned with shareholder interests or otherwise problematic[vi]. In determining any misalignment, Fidelity will take into account, among other factors, whether:

- A company has an independent Compensation Committee
- The Compensation Committee engaged independent compensation consultants
- The Compensation Committee waived equity vesting restrictions
- The company adopted or extended a golden parachute without shareholder approval[vii]

Fidelity will also:

- Support annual advisory votes on executive compensation
- Generally vote against proposals to support golden parachutes[ix]

Equity Plan Votes – New Share Requests

The guideline for determining votes related to new share requests is now based on a company's three-year average burn rate, instead of the dilutive effect of the proposed plan (the basis for the previous guideline)[viii]. The guidelines state that Fidelity will generally vote against approval of additional shares if a company's three-year average burn rate exceeds certain caps.

Companies	3-Yr. Avg. Burn Rate
Large Capitalization (A company included in the Russell 1000 Index)	1.5%
Small Capitalization (A company not included in the Russell 1000 Index that is not a Micro-Capitalization Company)	2.5%
Micro Capitalization (A company with market capitalization below US $300 million)	3.5%

iv Available at: http://personal.fidelity.com/myfidelity/InsideFidelity/InvestExpertise/governance.shtml.tvsr.

v The guidelines also cover additional compensation-related topics, such as: bonus plan proposals (162m), equity exchanges/repricings, and employee stock purchase plans.

vi Fidelity funds sub-advised by Geode Capital Management LLC, which discloses its own set of proxy voting guidelines, will generally vote for proposals to approve executive compensation unless it believes the company has engaged in poor compensation practices (similar to Fidelity's general guidelines) or provided poor compensation disclosure (different from Fidelity's general guidelines).

vii Fidelity defines a "golden parachute" as: "employment contracts, agreements, or policies that include an excise tax gross-up provision; single trigger for cash incentives; or may result in a lump sum payment of cash and acceleration of equity that may total more than three times annual compensation (salary and bonus) in the event of a termination following a change-in-control."

viii Fidelity funds sub-advised by Geode Capital Management LLC, which discloses its own set of proxy voting guidelines, will continue to focus on the dilutive effect of the plan; dilution may not be greater than 10% (15% for companies with a smaller market capitalization). If the plan fails this test, the dilution effect may be evaluated relative to any unusual factor involving the company.

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CAP Comment: *Similar to the prior dilution caps, if a burn rate exceeds the caps Fidelity will consider circumstances specific to the company or plans that lead it to conclude the burn rate is acceptable; details on mitigating factors not yet available.*

CAP Comment: *While Fidelity will be reviewing historic burn rate, it is not clear if they will consider prospective burn rate in terms of how many years the shares are expected to last. A duration of greater than five years is considered problematic by ISS. Glass Lewis has a similar policy, but uses a three-to-four year threshold.*

CAP Comment: *The guidelines do not make allowances for companies in industry groups that have historically had higher burn rates, such as technology. In contrast, ISS does vary burn rate caps by industry.*

CAP Comment: *Unlike ISS, Fidelity will not use a multiplier for full-value awards in its burn rate calculation. Since the calculation does not differentiate stock option awards and full-value stock awards, it could encourage greater use of full-value stock awards and less use of stock options.*

Additional equity plan voting guidelines include:

- Vote against equity plans where:
  1. Stock option exercise price is less than fair value on the grant date, unless the discount is 15% or less and is expressly granted in lieu of salary or cash bonus
  2. The plan's terms allow repricing of underwater stock options
  3. The Board or Compensation Committee has repriced outstanding options in the past two years without shareholder approval
- Vote against equity plans that include an evergreen provision[ix]
- Vote against equity plans that provide for acceleration of equity award vesting without an actual change-in-control occurring
- Require a restriction period of no less than three years for time-based share awards and a performance period of no less than one year for performance-based awards[x]

Conclusion

A clear shareholder preference for an annual Say on Pay vote frequency has emerged. In terms of the actual Say on Pay vote, it will be interesting to see what level of shareholder support becomes viewed as "acceptable," likely a higher hurdle than simply a pass / fail test. Based on current results, the acceptable "threshold" will be near 80% support, but that may change as the proxy season continues. Differences among industries may also emerge.

Where Fidelity's support is desired for Say on Pay votes or new share requests, it will be important to take their policies into account when: making compensation-related decisions, putting together the Compensation Discussion and Analysis, and preparing shareholder proposals (Say on Pay, new long-term incentive plans and/or share requests, etc.).

Please contact us at (212) 921-9350 if you have any questions about the issues discussed above or would like to discuss your own executive compensation issues. You can access our website at www.capartners.com for more information on executive compensation.

ix A feature which provides for an automatic increase in the shares available for grant under an equity plan on a regular basis.

x Shorter periods are permitted for up to 5% of a plan's shares for Large-Capitalization companies (10% for Small- or Micro-Capitalization companies).