

# Daily Journal

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## Proxy Season 2012: The Role of Supplemental Proxy Solicitations

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We are now more than halfway through the 2012 annual shareholder meeting season for Russell 3000 companies. As of last Wednesday, 1,714 Russell 3000 companies have held their 2012 meetings and conducted their second mandatory say-on-pay votes under the Dodd-Frank Act. The overall vote results continue to be very consistent with those reported through mid-May and with the final 2011 say-on-pay vote results, except that the percentage of companies which have failed their 2012 votes has increased.

During the 2011 season, approximately 1.2 percent of the Russell 3000 companies received less than 50 percent shareholder support for their say-on-pay votes. This percentage had grown to approximately 2 percent as of mid-May and has increased through June 13 to approximately 2.6 percent, with 45 companies having failed their votes. The other important metrics are more in line with those of 2011: 73 percent of the companies have passed their votes with more than 90 percent support, and 91 percent have passed their votes with more than 70 percent support. For more information on these numbers and other 2012 say-on-pay vote statistics

and insights, see <http://www.semlerbrossy.com/sayonpay>.

Also consistent with the 2011 trend and gaining impetus in 2012, the single biggest say-on-pay issue continues to be pay for performance, with Institutional Shareholder Services (ISS) and Glass-Lewis, the two leading U.S. proxy advisers, issuing negative recommendations on at least 14 percent of the votes, on the grounds that the companies' executive pay is not aligned with their performance. In this year's votes, ISS' negative say-on-pay vote recommendations, on average, have resulted in 30 percent less support. For an in-depth analysis of pay-for-performance issues see our Director Note published by the Conference Board, "The Conference Board Director Notes: Proxy Season 2012: The Year of Pay For Performance," available at <http://www.lw.com/thoughtLeadership/proxy-season-2012-the-year-of-pay-for-performance>.

Again, consistent with the 2011 theme and gaining momentum in 2012, companies which have received negative say-on-pay vote recommendations from the proxy

advisers have been preparing additional materials to use in soliciting proxies, and filing them with the SEC. As of June 13, 105 companies which received negative proxy adviser recommendations had filed supplemental proxy materials, with 94 percent contesting negative pay-for-performance determinations.

While some have questioned the effectiveness of preparing and filing supplemental proxy solicitation materials based on 2011 and early 2012 statistics that show no meaningful difference in the percentage of shareholder support for those companies that filed supplemental proxy materials and those that did not, it is often helpful and important to do so for several reasons.

First and foremost, the SEC's proxy rules not only require that companies file their shareholder proxies and amendments with the SEC, but also require that companies file any written instructions or other materials given to persons making personal solicitations for proxies that will be used directly or indirectly in making the solicitations, no later than the date that those materials are first sent to those persons. See 17 C.F.R. Section 240.14a-6. While there is little authority construing this rule and its scope, in its Staff Interpretations and comment letters the SEC staff has repeatedly said that written solicitation materials must be filed and that they include scripts used in soliciting proxies by personal interview, telephone, television or radio, as well as outlines, instructions or other written materials that are furnished to

company employees or proxy solicitors to assist them in answering stockholder inquiries. Most practitioners believe that materials used to solicit proxies that are not widely disseminated and simply refer investors to statements made and numbers disclosed in a company's proxy statement do not constitute such solicitation materials. However, when the solicitation materials contain additional numbers, disclosures, analyses or arguments, most careful practitioners advise companies to draft these materials in a form suitable for public distribution (by mailing or website posting) and for filing.

However, given the paucity of SEC enforcement activity in this area and line drawing issues, it would not be surprising to learn that some companies distribute additional materials to employees and proxy advisers to be used in solicitations without filing them. Informality and possibly lax practices may mean that companies which are not filing supplemental proxy solicitation materials are using them and engaging with shareholders in the same manner and extent as filing companies. This may explain why the statistics do not indicate much of a vote difference between companies that file and those that do not.

Second, it is very common for companies and their advisors to conclude that proxy adviser negative recommendations on pay for performance or other say-on-pay vote issues do in fact raise new issues or make arguments which should be challenged directly and crisply in supplemental materials, even if discussed in the company's proxy. Unless a company decides that it should not solicit proxies either directly or through proxy solicitors, in many cases additional solicitation materials should be prepared, made publicly available and filed with the SEC.

Third, while the filing of supplemental materials may not influence all shareholders on how

they vote on say-on-pay, in many cases they have influenced important shareholders. The degree of their influence turns largely on the identity of the company's shareholders, their internal voting guidelines and practices, and the strength of a company's case. In some cases, shareholders have been persuaded by a careful analysis of the arguments in the supplemental materials. In other cases, investors who have wanted to support a say-on-pay vote have not cared to dive into the details, but have simply needed to have supplemental materials in their file to support their decisions. In any event, engaging with shareholders on important issues argued in supplemental materials can make the difference between failing and passing a vote, or getting over the important 70 percent bar.

Fourth, having a company's management, compensation consultants, legal advisors and proxy solicitors work together to analyze negative recommendations, the shareholder base and their voting guidelines, and to formulate appropriate responses can help a company better understand its pay plans, peer group practices, and shareholder and proxy adviser concerns. Preparing supplemental proxy materials is an excellent analytical exercise for a company which can affect the design and presentation of its pay plans, performance, peer groups, proxy formats, etc., for votes to come. Further, involving the company's Compensation Committee in preparing these materials can help the committee understand the implications of its prior decisions and future actions. Depending on the facts, this exercise may lead to pay plan changes, better disclosure, a clear understanding that the proxy advisers simply have it wrong, or something in between.

Fifth, the filing of supplemental proxy materials is an important step in engaging with shareholders. These filings can lead to good discussions

and better understandings, as well as create a record of shareholder engagement which should be described in the proxy for the next say-on-pay vote when the company discloses, as required by the SEC rules, if and how it has taken the results of the prior year's vote into account in designing its pay plans. These discussions with key shareholders about the issues and arguments documented in supplemental solicitation materials can be most effective when continued after the 2012 proxy season when investors have time to engage on the issues. This can lead to a better vote outcome on the next say-on-pay vote.

Finally, the filing of these supplemental proxy solicitation materials by many companies has created a public record of the voting policies, recommendations and analytics of the proxy advisers which otherwise would not be subjected to public disclosure, scrutiny and analysis. The supplemental filings in 2011 and the current proxy season have exposed substantial problems with the proxy advisers' policies, analytics and their application. The cumulative effect of these filings has been to pressure the proxy advisers to be more careful in their work and to improve how they do their business.

The 2011 pressure has resulted in ISS improving its 2012 pay for performance analytics and the formation of a partnership between Equilar and Glass Lewis, which hopefully will take the next step on pay for performance analytics by developing better peer group definitions and using realizable pay rather than pay opportunities for measuring alignment between pay and performance. Given the increased 2012 blowback, it is likely that the proxy adviser's policies and practices will continue to evolve in a better direction as companies expose them in their supplemental filings for the world to see, analyze and compete against.