The Latest Word on 2011 Say on Pay Vote Recommendations

Dodd-Frank and Proposed Say on Pay Vote Rules

On October 18, 2010, the Securities and Exchange Commission (SEC) published proposed rules (Proposed Rules) implementing Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act). Section 951 generally requires US public companies to provide their shareholders the right to cast three types of pay votes: (i) a vote to approve the compensation of the named executive officers (say on pay vote); (ii) a vote on the frequency with which shareholders should be entitled to cast votes on the company’s executive compensation (frequency vote) and (iii) a vote to approve certain payments made in connection with an acquisition, merger or other specified corporate transaction (golden parachute vote). As of this date, the SEC has not adopted any final rules on the say on pay votes, but they are expected any day.

This Commentary provides a brief overview of the Proposed Rules and their effective dates, the current institutional and public company say on pay trends and what companies should be doing now to prepare for their 2011 say on pay votes. For a more detailed overview of the Proposed Rules, please see our Client Alert: SEC Announces Preliminary Say on Pay Rules, dated November 4, 2010.

Bottom Lines

The bottom lines are that US public companies are generally required to hold say on pay and frequency votes at their first meetings of shareholders occurring on or after January 21, 2011. Public companies are not required to hold golden parachute votes until the SEC promulgates the final rules. The SEC expects to issue the final rules between January and March of 2011. Until that time, public companies holding shareholder meetings on or after January 21, 2011 are only required to hold say on pay and frequency votes. Public companies may, however, ultimately avoid a golden parachute vote if they properly disclose their golden parachute arrangements and subject them to a general say on pay vote, provided that the arrangement is not modified after its prior approval.

Generally, the Proposed Rules do not mandate any specific language in constructing their say on pay and frequency proposals. With respect to the say on pay vote, the proxy statement must explain that the vote is a separate vote covering all of the executive compensation disclosed in the proxy statement and state the general effect of the vote including whether the company will be bound by the outcome. With respect to the frequency vote, the proxy card must provide the shareholders with four voting alternatives: (i) annual, (ii) biennial or (iii) triennial say on pay votes and (iv) abstention; and the proposal must disclose the general effect of the frequency vote including whether the company will be bound by the outcome. The Proposed Rules require that a public company hold a frequency vote at least once every six years. By their literal terms, the Proposed Rules require proxies to include resolutions subject to the various votes. The Proposed Rules do not require that companies make recommendations on the votes, but most should and will.
Early Trends on Say on Pay and Frequency Vote Recommendations

Heading into the 2011 proxy season, trends have started to emerge in both institutional guidance and filed proxy statements with regard to say on pay votes and frequency votes. With respect to say on pay votes, as of December 31, 2010, 73 companies had filed proxies recommending approval of the compensation paid by them to their named executive officers in the 2010 calendar year or a fiscal year ending late in 2010.

With respect to the frequency vote, a couple of institutional shareholders and proxy advisors have publicly adopted formal voting policies stating their preferences for annual say on pay votes (including Institutional Shareholder Services (ISS) and Fidelity Investments). Other institutional shareholders are informally advising companies and advisors of their preferences. Just how strongly any of the proxy advisors or institutional shareholders feel about their preferences generally will not be known until the meeting season gets into full swing and we see what they recommend and how they vote their shares in particular cases. But as of December 31, 2010, 73 companies with shareholder meetings on or after January 21, 2010 had filed either preliminary or definitive proxy statements. While it is very early in the proxy season, very significantly, 41 of the 73 companies (or 56%) that have filed proxy statements as of December 31, 2010 have recommended triennial votes. Further, 17 (23%) have recommended annual votes, 8 (11%) have recommended biennial votes and 7 (10%) have not made a frequency recommendation. Large accelerated filers have leaned significantly towards a triennial vote recommendation. Of the 34 large accelerated filers who have filed proxy statements, 21 (62%) have recommended triennial votes, 6 (18%) have recommended annual votes, 3 (9%) have recommended biennial votes and 4 (12%) have not made recommendations. However, even smaller reporting companies have favored triennial vote recommendations; by our count as of December 31, 2010, 10 of 18 (56%) filers have recommended triennial votes.

Recently filed proxies also reveal certain trends in the language used in both the say on pay and frequency vote proposals. 53 of the 73 (73%) proxy statements include shareholder resolutions in their say on pay and frequency proposals, which is consistent with the literal language of Dodd-Frank and the Proposed Rules. 19 of the 34 (56%) large accelerated filers have also included an executive summary of their compensation discussion and analysis section to assist shareholders in reviewing the company’s executive compensation before casting their votes. Most of the proxies also provide supporting statements to the proposals to persuade the shareholders to vote for the Board’s recommendations. None of the filed proxies have contained any language which suggests that companies are seeking approval of their golden parachute so as to avoid subjecting them to a golden parachute advisory vote at the time of a corporate transaction. A couple of filed proxies structured its say on pay and frequency vote proposals in a question and answer format, which may be a more user-friendly format for shareholders to read and understand.

What Should You Be Doing Now?

Consider Frequency Vote Recommendation

One of the most important issues facing public companies this proxy season will be determining what recommendations to make to shareholders regarding the future frequency of say on pay votes. Whether a public company should subject its compensation practices to an annual, biennial or triennial say on pay vote depends on the unique facts and circumstances surrounding each company’s pay practices and relations with its shareholders, ISS and other proxy advisors, and other circumstances.

While each company’s situation will differ, the following non-exhaustive list sets forth the considerations and support for each of these alternatives.

Annual Votes:

- Annual votes will allow shareholders to provide the company with their direct input on the compensation philosophy, policies and practices as disclosed in the proxy statement every year.
Annual votes may be consistent with company policies of annually seeking input from, and engaging in discussions with, the shareholders on corporate governance matters and executive compensation philosophy, policies and practices.

Less frequent votes may allow an unpopular pay practice to continue too long without timely feedback.

Shareholder activists and proxy advisors who think public companies should be kept on a short leash on compensation matters likely will support annual vote recommendations and may oppose the less frequent alternatives.

Annual votes may take some of the pressure off director elections by allowing ISS and other proxy advisors to recommend against a say on pay vote over perceived problematic pay practices, rather than against the reelection of Compensation Committee or other Board members.

**Triennial Votes:**

- For companies with executive compensation programs that are designed to support long-term value creation and to incentivize and reward performance over a multi-year period (as is very commonly the case), triennial votes will allow shareholders to better judge the program in relation to the company’s long-term performance.
- Triennial votes will provide the company with the time to thoughtfully consider the results of their say on pay votes, respond to shareholders sentiments and implement changes.
- Triennial votes will provide shareholders sufficient time to evaluate the effectiveness of short- and long-term compensation strategies and related business outcomes of the company (whereas annual votes would not allow for changes to the company’s compensation program to be in place long enough to evaluate whether the changes were effective).
- Less frequent say on pay votes will improve the ability of institutional shareholders to exercise their voting rights in a more deliberate, thoughtful and informed way that is in the best interests of shareholders.
- Shareholders are able to provide input on an ongoing basis through other means, such as shareholder approval requirements for equity compensation plans and other compensation-related matters (including in years where there is no say on pay vote).

**Biennial Votes:**

- Biennial votes strike a balance between annual and triennial votes and incorporate the positive attributes of both and compromise the shortcomings of each (see above).

**No Recommendation?**

Alternatively, companies that do not have a view on the best frequency for them, or that may not want to bias their shareholders, may decide not to make any recommendation to shareholders on the frequency vote, as has been done by 7 companies as of December 31, 2010. However, we believe that Boards should be encouraged to think through these issues and make a recommendation, if for no other reason than to make it clear to their shareholders that they thoughtfully considered the issues, asserted ownership of the issues and have not abdicated the good governance playing field to proxy advisors.

Further, shareholders who are used to seeing company recommendations may be confused by the lack of a recommendation, which may result in more no votes with regard to the frequency vote. And, if a proxy card is returned signed but with no frequency vote designation, the proxy holder (generally, the company’s management) has the discretion to vote its recommendation as indicated on the proxy card; therefore, if no management recommendation is asserted, management loses this opportunity.

**Review Current Practices**

By now, companies should have reviewed their pay practices and eliminated any unjustifiable practices. Companies should review records on prior shareholder votes and proxy advisory
recommendations on equity plans and the reelection of Compensation Committee members to identify any potential problems for their say on pay votes.

Consider Inclusion of Executive Summary in Compensation Discussion And Analysis

Companies should consider including an executive summary at the beginning of the Compensation Discussion and Analysis sections in their proxies, so that they provide shareholders with easy access to the information needed to cast informed say on pay votes.

Given that ISS and other proxy advisors will have to deal with as many as 9,000 US proxy statements during the 2011 season, companies should use an executive summary to list all of the features that are on proxy advisors’ checklists (such as stock ownership and holding requirements, claw-back provisions, absence of tax gross-up provisions and tax reimbursements). Further, if companies maintain any potentially problematic pay policies that they believe are justified and valuable, they should address them and discuss the benefits of the policies so that they may publicly provide their points of view on these issues when dealing with proxy advisors and shareholders.

Finally, companies should use their executive summaries to discuss how their executive pay aligns with their financial performance, and further, how their executive pay and performance compare to the pay and financial performance of their peers. This is ultimately far more important to shareholders than a check-the-box analysis of compensation practices and will be even more important in 2012 when the Act’s “pay-versus-performance” disclosure requirements take effect.

All of these issues and updated statistics on the latest proxy filings will be discussed on our webcast with Georgeson, Inc.: “2011 Proxy Season: Handling Say on Pay Votes, Dealing with Institutional Shareholders and Proxy Advisors and Drafting Proxy Statements” on January 19, 2011, at 1 PM ET. The webcast will be archived on our website for later viewing. Please sign up to view the webcast live (or later at your convenience) by clicking here.

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