



Interpreting Say on Pay - What will you say?

Congratulations on surviving a challenging 2011 annual meeting proxy season. For most companies, this was your first annual meeting featuring the newly-mandated Say on Pay (SoP) and Say When on Pay (SWoP) proposals.

Rather than considering this initial vote to be an “event” that is behind you, we feel you should consider this to be the initial benchmark of an ongoing, year-round process. If you are among the companies receiving 90+% support on your SoP proposal, congratulations are in order (at least for this year). If, however, you are among the many companies receiving less than 80% support for your proposal, there is some work ahead of you.

In this piece, we will discuss “degrees of success or failure”, steps you can take to “interpret” the vote -- particularly any significant degree of opposition – and steps you can take to improve future results.

FREQUENCY OF SAY ON PAY – THE EARLY SPRING DISTRACTION

At the beginning of 2011, while most companies knew they would be including Say on Pay proposals in their proxies, the primary discussion appeared to be about which future frequency to recommend. This commanded significant attention and discussion between companies, their investors and advisors.

As it turned out, at most companies - including those recommending other than annual frequency - shareholders voted in greater numbers for annual frequency. The good news is that we do not expect companies will encounter any “year-two backlash” solely for having recommended less-than-annual frequency in the initial vote - provided you subsequently follow the frequency supported by a plurality or majority of shares voting. The strong support for Annual, regardless of Management’s recommendation, can be seen in the tables below:

| Management Recommendation: | Annual | Biennial | Triennial | None |
|----------------------------|--------|----------|-----------|------|
| Ballots: | 923 | 51 | 688 | 50 |
| % of Total: | 53.9% | 3.0% | 40.2% | 2.9% |

| Avg. Support when Management Recommends: | Annual | Triennial |
|--|--------|-----------|
| Support for Annual: | 86.6% | 50.2% |
| Support for Triennial: | 10.9% | 46.5% |

SAY ON PAY – THE MAIN EVENT

More important, for a lesser but still significant number of companies, either:

- Shareholders did not approve your SoP proposal, or
- SoP “passed”, but with the owners of a meaningful percentage of shares registering their opposition

In either case, the stakes are higher, and how you subsequently respond to this vote may have significant near and longer-term impact on your company and its perception.

SO HOW SHOULD YOU MEASURE SUCCESS OR FAILURE?

Success in SoP, much like beauty, is in the eye of the beholder. Under any standard, clearly a majority or greater of votes cast AGAINST your SoP proposal would be deemed “failure”. However, depending on the audience, it really is more of a sliding scale. Consider how, in the past, ISS, investor activists, sympathetic media and others consistently describe shareholder initiatives achieving 30% or higher support as “strong expressions of support” (seemingly ignoring the votes of the other 70%).

With votes FOR this year’s 1,761 SoP proposals averaging roughly 90% of votes cast, it is probably fair to consider the first 10 or 15% AGAINST votes as an acceptable level of “noise” not requiring further analysis. However, it is equally fair to say that companies with 30% or higher votes AGAINST SoP will find themselves on short-lists of companies whose shareholders are not fully behind their pay practices. This negative visibility and related reputational risk increase at higher levels of negative votes.

For these companies, it will be very important that investors and their proxy advisors believe that the underlying causes of their “year-one” dissatisfaction – whether company performance, pay practices or their disclosure – have been credibly addressed by year two. If this does not occur, then in addition to continuing to vote against SoP, investors may raise the stakes, including filing additional proposals, criticizing the company publicly, and even withholding voting support from individual directors, the board compensation committee, or the full board.

| SoP by Tier: | 0-49.9% | 50-69.9% | 70-79.9% | 80-80.9% | 90-100% |
|--------------|---------|----------|----------|----------|---------|
| Ballots: | 29 | 112 | 135 | 288 | 1197 |
| % of Total: | 1.6% | 6.4% | 7.7% | 16.3% | 68.0% |

In assessing your degree of “SoP visibility risk”, you should determine the relative ranking of your level of voting opposition -- both to the overall market, and to your peer companies.

Now the real work begins

This year-one experience is but the beginning of an ongoing process, in which:

1. companies explain (in their proxy statement and through other means) their pay programs and why they are appropriate and deserve shareholder support;
2. shareholders provide their non-binding advisory vote;
3. companies analyze the vote, including identifying who cast the larger negative votes and what drove their negative voting;
4. following the initial SoP vote, companies disclose on an SEC Form 8-K how often they will hold the SoP vote going forward (and must do so 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);
5. companies consider implementing ongoing engagement and dialogue with top investors to demonstrate their commitment to understanding investor views, identify and head-off future negative voting, and “let steam out of the kettle”;
6. in the 2012 proxy, the Compensation Discussion and Analysis (CD&A) should disclose whether, and if so how, companies have considered the results of the most recent say-on-pay vote;
7. companies consider making changes to their compensation programs they think are appropriate given their unique circumstances. NOTE – companies should avoid making changes that don’t benefit the company or its compensation programs, merely to improve future votes (i.e. tail wagging the dog);
8. companies consider improvements to the related disclosure designed to improve shareholder understanding and future support;
9. at the next annual meeting, shareholders again provide their non-binding advisory vote;
10. rinse, repeat... and the cycle begins again.

WHY DID WE GET NEGATIVE VOTES?

- Proxy Advisor policies: Pay for Performance, Poor Pay Practices, etc.?
- Internal guidelines of one or more institutional investors?
- Poorly or misunderstood pay practices or their disclosure (i.e. programs too complex, or disclosure imperfectly explained)?

WHAT CAN WE DO ABOUT IT?

- 1) Do nothing (good luck!):
 - Let the future voting chips fall where they may
 - Hope your detractors sell and friendly investors buy
 - Hope your company performance improves
- 2) Identify which of your larger investors voted against. If the reason for this negative vote is not clear, engage with them to determine their rationale for voting AGAINST, and what they need to see in order to support you in the future. Once this is accomplished, you can then:
 - Amend certain pay practices
 - Publicize and “take credit” for these changes
 - Improve your proxy disclosure including the CD&A

WE CAN HELP

For information on Phoenix and how our year-round advisory model can help your company address the ongoing challenges posed by Say on Pay, contact us at:

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ⁱAll SoP and SWoP data in this piece are per ISS Governance Analytics for meetings from 1/1/11-5/31/11 where results were available.

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