Preparing for the 2012 Proxy Season:
Governance and Executive Compensation Strategies

Brought to you by Winston & Strawn's M&A, Securities and Corporate Governance Practice Group and Employee Benefits and Executive Compensation Practice Group
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I. Recent Developments and Strategies for the 2012 Proxy Season

- Say on Pay Lessons and Strategies
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- Preview for next webcast session on October 19, 2011
I. Recent Developments and Strategies for the 2012 Proxy Season
Say on Pay Lessons and Strategies – 2011 Results

- Overall high passage rate for Say on Pay
- Approx. 37 companies (1.6% of Russell 3000) failed to obtain majority approval of their Say on Pay proposals
  - Institutional Shareholder Services (ISS) cited Pay for Performance Disconnect or Problematic Pay Practices at most of these companies
- ¾ of companies passed with over 90% approval*
- ISS recommended a vote AGAINST Say on Pay at approximately 13% of companies it reviewed*
- ISS effect?
  - Average approval with ISS “for”: 94%*
  - Average approval with ISS “against”: 69%*

* Data from Semler Brossy Consulting Group, LLC – July 21, 2011 Russell 3000 Summary
Say on Pay Lessons and Strategies – 2011 Trends

- Executive Summaries in CD&A
- Pay for Performance Emphasis in Disclosure
- Supporting Statements
- Overall Proxy Statement Executive Summary
- Supplemental Proxy Solicitations
- Proxy Solicitor Efforts
  - Get-out-the-vote efforts
  - Stockholder and ISS outreach
  - Deconstructing negative votes
- Stockholder lawsuits at companies with failed Say on Pay votes

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Say on Pay Lessons and Strategies – Say on Pay Frequency 2011 Trends

■ Annual frequency most common result
  - Very few Large-Cap Cos received support for Biennial or Triennial
  - Small/Mid-Cap Cos were more likely (than Large-Cap) to receive support for Biennial or Triennial frequency

■ Overall Results:
  - 80% of companies received stockholder support for Annual frequency*
  - 20% of companies received stockholder support for Triennial frequency*
  - A handful of companies received stockholder support for Biennial frequency*

■ Approximately ½ of companies announced their frequency decision in the original Form 8-K announcing meeting results in Item 5.07

* Data from Semler Brossy Consulting Group, LLC – July 21, 2011 Russell 3000 Summary
Say on Pay Lessons and Strategies – Action Items

- If Say on Pay passed, don't get complacent
  - New CD&A requirement - action and disclosure re: impact of Say on Pay
  - Pending ISS policy re: response to shareholders

- What's your frequency?
  - If Annual, learn from this year
  - If Triennial, Compensation Committee may be target of ISS without Say on Pay “buffer”

- Start early and use your arsenal:
  - Education re: applicable policies (shareholder, ISS, SEC, etc.)
  - Disclosure counts – hot-button issues and heightened expectations
  - Shareholder outreach

- Important housekeeping - File Form 8-K/A (frequency) and Form S-8 (stock plans) and update/correct ISS GRId scores
The Dodd-Frank Act – Tentative Rulemaking Schedule

- Shareholder Say on Pay and Say on Pay Frequency (EFFECTIVE NOW; In 2013 for Smaller Reporting Cos)
- Shareholder Approval of Golden Parachute Compensation (EFFECTIVE NOW)
- Compensation Committee Member Independence (SEC Proposed Rules Issued March 2011; SEC Final Rules Due by December 2011; Still Need Exchanges to Issue Rules)
- Independence of Compensation Consultant, Legal Counsel, and Other Advisers (SEC Proposed Rules Issued March 2011; SEC Final Rules Due by December 2011; Still Need Exchanges to Issue Rules)
- Disclosure of Hedging by Employees and Directors (Proposed SEC Rules by December 2011; Final SEC Rules in January-June 2012)
- Pay Ratio Disclosure (Proposed SEC Rules by December 2011; Final SEC Rules in January-June 2012)
- Whistleblower (EFFECTIVE NOW)
- Proxy Access (Final Rules in 2010; Vacated by Court Decision on July 22, 2011)
- Disclosure Regarding Chairman and CEO Structures (EFFECTIVE NOW)
- Elimination of Discretionary Voting by Brokers on Executive Compensation Proposals (EFFECTIVE NOW)
Other Dodd-Frank Provisions – Say on Golden Parachute Pay 2011 Trends and Next Steps

- Through August 31, 2011, the results of 19 votes on golden parachute compensation have been reported
- 8 of 19 companies received >90% support
- Average support of 83.5%, with a low of 54.1%
- Many examples of CiC compensation receiving lower stockholder support than that of underlying merger

Action items:
- Think twice before incorporating enhanced CiC disclosure in annual proxy statement (ISS scrutiny)
- Learn nuances of golden parachute rules (disclosure vs. advisory vote, acquiror vs. target, double vs. single trigger, lump sum vs. installments)
Other Dodd-Frank Provisions – Compensation Committee Member Independence

- In determining the definition of the term “independence,” the national securities exchanges and associations must consider relevant factors to be determined and published by the SEC, including:
  - The source of compensation of a member of the company's board of directors, including any consulting, advisory, or other compensatory fee paid by the company to such member; and
  - Whether a member of the company's board is affiliated with the company, or a subsidiary or affiliate of the company

- SEC definition of “affiliate”: “a person that directly or indirectly controls, or is controlled by, or is under common control with, the issuer.”
  - Rule of thumb that more than 10% direct or indirect ownership of an issuer creates affiliate status

- Representative of a private equity fund (or a group of funds acting in concert) or other stockholder owning more than 10% of company could be precluded from serving on the company's Compensation Committee
Other Dodd-Frank Provisions – Compensation Committee Member Independence

- Independence rule does not apply to a “controlled company,” a limited partnership, or a company that is in bankruptcy proceedings (subject to possible exceptions for controlled, regulated institutions)

- SEC rules permit the national securities exchanges to exempt a particular relationship from the independence requirements, taking into consideration the listed company's size and other relevant factors

- Action items:
  - Beware that 10% owners may have to step down from the committee
  - However, monitor final rules – the proposed SEC rules lay the path for the exchanges to create an exception for large shareholders
Other Dodd-Frank Provisions – Independence of Compensation Consultants, Legal Counsel, and Other Advisers

- The Compensation Committee may only select a compensation consultant, legal counsel, or other adviser after taking into consideration factors identified by the SEC (see below)

- The Committee, in its sole discretion, may retain and obtain the advice of independent legal counsel and other advisers

- The Company must provide for appropriate funding, as determined by the Compensation Committee, for payment of reasonable compensation to independent legal counsel or any other adviser
Other Dodd-Frank Provisions – Independence of Compensation Consultants, Legal Counsel, and Other Advisers

- Dodd-Frank does **not** require a Compensation Committee to hire its own independent compensation consultant, legal counsel, or other advisers.

- Dodd-Frank states that it should not be construed to:
  - Require the Compensation Committee to implement or act consistently with the advice or recommendations of the compensation consultant; or
  - Affect the ability or obligation of the Compensation Committee to exercise its own judgment in fulfillment of the duties of the Compensation Committee.
Other Dodd-Frank Provisions – Independence of Compensation Consultants, Legal Counsel, and Other Advisers

- Requires the SEC to identify factors that affect the independence of legal counsel to a Compensation Committee

- These factors shall include at least:
  - The provision of other services to the company by the firm that employs the compensation consultant, legal counsel, or other adviser;
  - The amount of fees received from the company by the firm that employs the compensation consultant, legal counsel, or other adviser, as a percentage of the total revenue of that firm;
  - The policies and procedures of the firm that employs the compensation consultant, legal counsel, or other adviser, which are designed to prevent conflicts of interest;
  - Any business or personal relationship of the compensation consultant, legal counsel, or other adviser with a member of the Compensation Committee; and
  - Any stock of the company owned by the compensation consultant, legal counsel, or other adviser

- The SEC's proposed rules don't identify any other factors
Other Dodd-Frank Provisions – Independence of Compensation Consultants, Legal Counsel, and Other Advisers

- Beginning with the proxy statement for the annual meeting occurring on or after July 16, 2011, Dodd-Frank requires disclosure of whether the Compensation Committee retained or obtained the advice of an independent compensation consultant and whether the consultant's work raised any conflict-of-interest issues (and, if so, the nature of the conflict and how the conflict is being addressed), but no disclosure on those issues with respect to legal counsel or other advisers.

- Action items:
  - Comply with enhanced disclosure requirements re: consultants
  - Consider and discuss need for independent legal counsel under certain circumstances
Other Dodd-Frank Provisions – Policy on Recovery of Erroneously Awarded Compensation – Clawback

- Dodd-Frank requires SEC to direct the national securities exchanges to prohibit the listing of any security of an issuer that does not develop and implement a “Recovery of Erroneously Awarded Compensation Policy”

- Policy must provide for disclosure of the policy of the issuer on incentive-based compensation that is based on financial information required to be reported under the securities laws
Other Dodd-Frank Provisions – Policy on Recovery of Erroneously Awarded Compensation – Clawback

- The policy must provide that,

  "In the event that the issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws, the issuer will recover from any current or former executive officer of the issuer who received incentive-based compensation (including stock options awarded as compensation) during the 3-year period preceding the date on which the issuer is required to prepare an accounting restatement, based on the erroneous data, in excess of what would have been paid to the executive officer under the accounting restatement"
Other Dodd-Frank Provisions – Policy on Recovery of Erroneously Awarded Compensation – Clawback

- **Individuals Covered:** Compensation clawback policy must apply at least to the individuals who are **executive officers** and individuals who **formerly** were executive officers.

- **Compensation Covered:**
  - Incentive-based compensation that is based on financial information required to be reported under the securities laws, and
  - Incentive-based compensation (including stock options awarded as compensation) in excess of what would have been paid but for the erroneous data in the reported financial information.
Other Dodd-Frank Provisions – Policy on Recovery of Erroneously Awarded Compensation – Clawback

- **Committee Discretion**: None – “will recover”
- **Clawback Period**: The 3-year period preceding the date the Company is “required to prepare an accounting restatement”
- **Triggering Event**: The company is required to restate its financial statements as the result of material noncompliance with any financial reporting requirement under the securities laws
Other Dodd-Frank Provisions – Policy on Recovery of Erroneously Awarded Compensation – Clawback

- Dodd-Frank expands on SOX Section 304, which
  - Only applies to the chief executive officer and the chief financial officer,
  - Only requires a look-back period of one year, instead of three, and
  - Only applies if the financial restatement is a result of misconduct

- Action items:
  - Assess current recoupment policy, if any, versus Dodd-Frank requirement
  - Consider incorporating a “place-saver” in any new plan documents, award agreements, and employment agreements
  - Consider early adoption of Dodd-Frank compliant policy, recognizing that some changes may be necessary pending final rules and guidance
Other Dodd-Frank Provisions – Disclosure of Hedging by Employees and Directors

- Dodd-Frank requires companies to disclose in their annual proxy statement whether the company permits any employee or director (or any designee of such employee or director) to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars, and exchange funds) that are designed to hedge or offset any decrease in the market value of equity securities:
  - granted to the employee or director by the company as part of the compensation; or
  - held, directly or indirectly, by the employee or director

- Action items:
  - Review existing policies
  - Consider early adoption of a compliant policy
Other Dodd-Frank Provisions – Disclosure of Pay Versus Performance

- Requires Company to disclose in its proxy statement:
  
  “information that shows the relationship between executive compensation actually paid and the financial performance of the issuer”

- “Financial performance” includes any change in the value of the company's stock and dividends or other distributions

- Presumably, this is to be calculated in the same manner as the Performance Graph required in the annual report, based on cumulative total stockholder return
Other Dodd-Frank Provisions – Disclosure of Pay Versus Performance

- **Open issues:**
  - The definition of the new term “compensation actually paid.” Does this include gains actually recognized in the year on equity awards from prior years? Does it include a bonus actually paid in the year but attributable to a prior year?
  - Whether this disclosure applies to the compensation of the named executive officers only, all of those in the Section 16 group, or some other group
  - Whether this new disclosure requirement applies to the same five-year period as the existing Performance Graph and, if so, how to show fluctuating annual bonuses

- **Action items:**
  - Monitor proposed rules for clarification on open issues
  - Continue to utilize meaningful graphs, charts, and statistics to show your company's pay for performance connection
Other Dodd-Frank Provisions – Pay Ratio Disclosure

- Requires company to disclose, “in any filing of the issuer”:
  A. The median of the annual total compensation of all employees of the company, except the chief executive officer (including employees outside the U.S.);
  B. The annual total compensation of the chief executive officer (or any equivalent position) of the company; and
  C. The ratio of the amount described in subparagraph (A) to the amount described in subparagraph (B)

- Company must calculate annual compensation using the rules for Total Annual Compensation figure in the SCT

- Flexibility in forthcoming SEC rules is unlikely; however, House efforts are underway to repeal this requirement

- Action items:
  - Briefly assess compliance cost and effort
  - Monitor adoption/repeal status
Other Dodd-Frank Provisions – Conflict Minerals

- SEC proposed rule December 2010; final rule expected by end of 2011
- Expected to apply to U.S. and foreign issuers and smaller reporting companies subject to Exchange Act reporting
- Requires disclosure when “conflict minerals” are necessary to the production or functionality of a product manufactured by or contracted for manufacture by a reporting company
  - Recycled or scrap materials expected to be excluded
  - No *de minimus* threshold
Other Dodd-Frank Provisions – Conflict Minerals

“Conflict minerals” defined as columbite tantalite (used to make tantalum), cassinterite (used to make tin), gold, wolframite (used to make tungsten), derivatives thereof, or any other mineral determined to be financing conflict in the Democratic Republic of Congo or adjoining countries (the “DRC countries”)

- Examples: Jewelry, computers, cell phones, other electronics, engines, tin cans
Other Dodd-Frank Provisions – Conflict Minerals

- Due Diligence Requirement
  - Companies must make reasonable inquiries regarding the countries of origin of minerals used in their products

- Disclosure Requirements
  - Disclose company’s determination in Form 10-K and on website
  - Disclose due diligence inquiry conducted in Form 10-K
  - Maintain supporting records
  - If used, prepare Conflict Minerals Report with detailed disclosure about conflict minerals originating in DRC Countries – furnish as exhibit to Form 10-K and on website
  - Website availability
Other Dodd-Frank Provisions – Conflict Minerals

- **Conflict Minerals Report**
  - Must include certified independent audit of report
  - Describe products not “DRC conflict free”
  - Identify facilities used to process/manufacture
  - Identify countries of origin
  - Describe due diligence efforts

- **Action Items**
  - Determine whether your company could be affected – expected to apply to wide range of companies
  - Understand current capabilities to verify sourcing
  - Consider establishing preliminary due diligence plan
Other Dodd-Frank Provisions – Whistleblower Rules

- **Whistleblower Rules**
  - **Eligibility:** Whistleblower must voluntarily provide “original” information leading to a successful enforcement action in which the SEC obtains more than $1,000,000
  - **Potential Awards:** Awards may amount to between 10 and 30 % of the total monetary sanctions collected in a successful SEC action, determined at its discretion
  - Effective August 2011
  - Recent House Bill (H.R. 2438) proposes to modify whistleblower provisions to require, among other things, that an employee first or contemporaneously report a matter internally as a condition to receiving the bounty
    - Referred to House Committees on Financial Services and Agriculture
Other Dodd-Frank Provisions – Whistleblower Rules

To Determine the award the SEC can consider:

- Significance of information provided by whistleblower
- Assistance provided by whistleblower
- Law enforcement interest in making a whistleblower award
- Participation by whistleblower in internal compliance programs
Other Dodd-Frank Provisions – Whistleblower Rules

- Whistleblowers are not required to use internal whistleblower procedures, although awards to whistleblowers may be increased by the SEC if the whistleblower first reports the information internally.
- Certain employees are not eligible to receive an award, including directors and officers (subject to exceptions), employees responsible for compliance, attorneys (both in-house and outside counsel), and independent public accountants.
- Whistleblowers (reporting internally or to the SEC) are protected from retaliation by providing them with a cause of action that provides relief in the form of reinstatement, double back-pay, and attorney fees.
Other Dodd-Frank Provisions – Whistleblower Rules

Action Items – Strengthening Internal Compliance Programs

- Establish and promote a culture of compliance
- Reinforce training and internal reporting among the workforce
- Establish and encourage plenty of reporting tools – managers, hotlines, and websites – all staffed by people trained in whistleblower protocol
- Zero tolerance for retaliating against those who report matters internally and externally
- Ensure that there is a quick and thorough response to internal and external whistleblower reports
- Consider positive, direct, and – where appropriate – confidential employee recognition for internal reporting
Proxy Access

- SEC adopted proxy access rules in 2010 – challenged in lawsuit by Business Roundtable and Chamber of Commerce
- On July 22, 2011, D.C. Circuit Court of Appeals vacated the SEC's proxy access rules (Rule 14a-11) in connection with lawsuit
  - The court determined that the SEC acted “arbitrarily and capriciously” for having failed to adequately assess the economic effects of the rule
- SEC also amended Rule 14a-8(i)(8) – not addressed by court but subject to “stay” of effectiveness (expected to expire Sept. 13)
  - Companies cannot exclude from proxy statements stockholder proposals relating to the right of stockholders to nominate directors or have stockholder director nominees included in proxy statement
Proxy Access

Expectations for 2012 proxy season

- No SEC mandated proxy access for 2012 proxy season
- Stay of effectiveness on Rule 14a-8(i)(8) likely to expire
  - Would require issuers to include stockholder proposals regarding proxy access – may lead to “private ordering”
  - Expect stockholder proposals requesting companies to amend governance documents relating to director nomination process and enhanced proxy access
  - SEC indicated in statement immediately following court ruling that the court's decision did not affect amended Rule 14a-8(i)(8)

SEC confirmed this week it is not seeking rehearing or appealing the court decision on mandated proxy access
Proxy Access

- Impact of court decision on future SEC rulemaking
  - Court focused on process necessary for SEC to satisfy Administrative Procedures Act – must consider efficiency, competition, costs of implementing, economic effects, and specific concerns raised in comment process
    - Amended Rule 14a-11 included lengthy cost-benefit analysis the court found inadequate
  - Decision impacts rulemaking beyond proxy access and SEC, particularly Dodd-Frank
  - Expect rulemaking delays
  - Expect increased litigation challenging pieces of Dodd-Frank
Proxy Access

Action Items

- Adopt advance notice bylaws if not already in place
- Develop company principles – Consider to what extent, if any, board would be willing to implement proxy access
- Consider company/board response to potential stockholder proposal on proxy access
  - Preemptively adopt process considered by board in advance
  - Include stockholder proposal in proxy statement
  - Include management proposal in proxy statement and argue to exclude stockholder proposal
Recent Areas of SEC Comment

- SEC reviews each reporting company's periodic filings at least once every three years and selectively reviews transactional filings
  - Could review without issuing any comments
  - May conduct full review or review for specific issues only
- Types of comments – SEC could request revisions to or additional disclosure in future filings, supplemental information, or amendment of a prior filing
- Compensation and accounting related issues are typically a major focus
Recent Areas of SEC Comment

- **Areas to Watch – Compensation and Legal Comments (non-accounting)**
  - Disclosure of performance targets used to determine compensation
  - Compensation benchmarking vs. data used only as “market check”
  - Compensation risk assessment disclosure (or absence thereof)
  - Disclose how various amounts of compensation were determined
  - **Board of directors disclosure/2010 enhanced proxy rules**
    - Director/nominee biographical information – be specific & include dates
    - Nominee qualifications – describe on an individual basis & be specific with respect to each nominees' key skills, experience, and attributes
    - Consideration of diversity – describe whether and how considered
    - Board leadership structure – must include discussion
    - Board role in risk oversight – must include discussion
Recent Areas of SEC Comment

- Areas to Watch – Compensation and Legal Comments (non-accounting) (cont.)
  - MD&A liquidity discussion – primary drivers of cash flows and liquidity needs; financial covenants; effects of market and industry conditions
  - Risk factors/MD&A trends discussion – adjusting trends and risk factors based on market conditions; company-specific
  - Legal proceedings/contingent liability disclosures – level of detail and timeliness of disclosure; consistent disclosure (particularly in light of any settlement)
  - Related party transaction disclosure – company-specific; policies and procedures
Recent Areas of SEC Comment

- Areas to Watch – Compensation and Legal Comments (non-accounting) (cont.)
  - Consistency in filed documents and other public statements – SEC may review other public statements and filings
  - Earnings projections/outlook – if included, “weak” disclosure may be targeted for comment
  - Non-GAAP financial measures – be consistent among filings/public information; follow Item 10(e) of Reg S-K requiring equal prominence and reconciliation (limited exception for certain CD&A information)
Recent Areas of SEC Comment

- **Action Items**
  - Consider whether company likely up for SEC review in 2012
  - Review prior Form 10-K and proxy statement for areas ripe for comment
  - Plan and draft in advance with attention to process, including allowing sufficient time for management review/participation
  - Follow through on commitments in prior comment letter responses
  - Evaluate risk factors and trend discussions in light of changing industry and market conditions
Trends in Stockholder Proposals

- Stockholder proposals cover three general categories
  - Executive compensation
  - Board of directors and takeover defense issues
  - Social and environmental issues

- Recent trends guide expectations for 2012 proxy season

- Total number of stockholder proposals at Fortune 100 companies decreased in 2011 (as reported by Proxy Monitor)
  - Attributable in part to adoption of Say on Pay and changes in common corporate governance practices
Trends in Stockholder Proposals

- **Executive Compensation Proposals**
  - **Require Holding of Equity Awards** – Proposals generally request a company to require senior executives to hold equity awards until after retirement or for a substantial period after the awards have vested
    - ISS reported average 24.1% support in 2011
  - **Golden Parachute** – Proposals generally seek non-binding stockholder approval of golden parachutes for executive officers
    - ISS reported average of 45.0% support in 2011

- **Board of Directors and Takeover Defense Issues**
  - **Declassification of Board** – Proposals generally seek to declassify the board so that each director must stand for re-election each year
    - ISS reported average of 73.5% support in 2011
Trends in Stockholder Proposals

- **Board of Directors and Takeover Defense Issues (Cont.)**
  - **Majority Vote Standard in Uncontested Director Elections** – Proposals seek amendment of bylaws requiring director nominees to receive a majority vote in uncontested elections
    - ISS reported average of 59.7% support in 2011
  - **Stockholder Action Through Written Consent** – Stockholder proposals generally seek amendment of bylaws allowing stockholders to take action by written consent without a stockholder meeting
    - ISS reported average of 48.4% support in 2011
  - **Supermajority Vote Provisions** – Stockholder proposals generally seek to amend bylaws to reduce supermajority vote requirements
    - ISS reported average of 59.3% support in 2011
Trends in Stockholder Proposals

- **Board of Directors and Takeover Defense Issues (Cont.)**
  - **Independent Chairman** – Proposals seek to separate the Chairman and CEO positions
    - ISS reported average of 34.6% support in 2011
  - **Stockholder Ability to Call Special Meetings** – Proposals generally seek amendment of bylaws allowing stockholders to call special meetings or reduce the stock ownership threshold required to call a special meeting (e.g., 10-25% of outstanding shares)
    - ISS reported average of 40.8% support in 2011
  - **CEO Succession Planning** – Proposals generally seek disclosure of a company's CEO succession planning policy
    - ISS reported average of 27.0% support in 2011 (two proposals went to vote)
Trends in Stockholder Proposals

Social and Environmental Issues

- **Reports on Political Spending** – Stockholder proposals request disclosure of political contributions and policies (including through trade associations) made with corporate funds
  - ISS reported average of 32.5% support in 2011
- **Sustainability Report** – Stockholder proposals request delivery of a report describing a company's actions to identify, understand, monitor, and manage sustainability issues. Proposals define sustainable businesses as encouraging lasting social well-being in their communities
  - ISS reported average of 29.4% support in 2011
Trends in Stockholder Proposals

- Social and Environmental Issues (cont.)
  - **Anti-Bias Sexual Orientation Policy** – Stockholder proposals ask companies to adopt policies on sexual orientation and gender identity
    - ISS reported average of 30.2% support in 2011
  - **Greenhouse Gas Emissions/Climate Change Principles** – Stockholder proposals generally request that companies disclose the impact of climate change on the company's operations and investments
    - ISS reported average of 17.0% support in 2011
Trends in Stockholder Proposals

- **Action Items**
  - Evaluate stockholder base and recent stockholder communications
  - Review and evaluate corporate governance and takeover defense structure and policies in light of market practices and current trends in stockholder proposals
  - Review ISS GRId scores (see following slides)
  - Consider recent trends in light of any issues of concern for management or the board and to highlight potential hot topics for stockholders
  - Consider whether to take any action in advance of 2012 proxy season
II. Engaging the Board on Latest Governance and Compensation Issues
Board Reactions to Dodd-Frank and Changing Environment – A General Counsel's Compensation and Governance Game Plan

- **Expect the unexpected** – Uncertain SEC rulemaking timing and challenges to rules
- **Fight information overload and misconceptions** – Educate the board on current issues, trends and emerging best practices
- **Stand behind your principles** – Company philosophies and principles on key compensation and governance issues should guide implementation of new rules and response to proxy advisors and stockholders
- **Avoid surprises** – Communicate with board members and constituents regularly
- **Play offense, not defense** – Plan ahead and be proactive
Managing Director Elections and Governance Process – Impact of Say on Pay

- Board focus on compensation issues
- Director elections – ISS “withhold” recommendation? (see below)

Impact of 2011 vote results
- If stockholder support was “low,” find out why and formulate Board action plan and response
- Anticipate ISS scrutiny of Board's responsiveness to shareholders
- CD&A requirement to discuss impact, if any, of Say on Pay vote on compensation policies and decisions

Managing issues relating to a triennial Say on Pay vote
- Compensation Committee may bear the brunt of ISS scrutiny in “off” years
Managing Director Elections and Governance Process – Impact of Say on Pay

Future Say on Pay Votes

- Frequency?
  - If annual, learn from this year
  - If triennial, the heat is still on

- Start early, use your arsenal:
  - Education re: applicable policies (stockholder, ISS, SEC, etc.)
  - Disclosure counts (cover hot-button issues)
  - Stockholder outreach (remember Reg. FD and proxy solicitation rules)

- Discuss executive compensation philosophy with board/committee
  - Ensure strong pay for performance relationship
  - ISS policies should inform but not guide the process
  - Having strong commitment to well-articulated philosophy is good preparation in case of disagreements with ISS policies and recommendations
Managing Director Elections and Governance Process – Impact of Proxy Advisory Firms

- Boards increasingly focused on governance best practices
  - Proxy Advisory Firms – ISS and Glass Lewis
  - Policies and voting recommendations impact director elections, vote outcomes on proposals, and company governance reputation

- Board Education
  - Understand proxy advisory firm potential impact and avoid surprises to board in 2012
    - Proxy advisory firms make voting recommendations on director elections and each proposal
    - Policies could lead to WITHHOLD or AGAINST vote recommendations
Managing Director Elections and Governance Process – Impact of Proxy Advisory Firms

- Board Education (cont.)
  - ISS Two-Part System – Policies/Voting Guidelines and Governance Scorecard/Governance Risk Indicators (“GRId scores”)
    - Policies/proxy voting guidelines used to establish voting recommendations in company proxy analysis report
    - GRId scores used to rank a company's governance risk level
    - ISS revising GRId score criteria prior to 2012 proxy season
    - GRId scores not necessarily a direct component of proxy voting recommendations, but some policy principles may overlap
Managing Director Elections and Governance Process – Impact of Proxy Advisory Firms

Understanding ISS Voting Recommendations and Policies

- Say on Pay (including “problematic pay practices”)
- Compensation Committee
- Equity plans
- Director elections
- Stockholder proposals
  - Compensation
  - Board of directors
  - Shareholder rights and takeover defenses
  - Social/environmental policies
Managing Director Elections and Governance Process – Impact of Proxy Advisory Firms

- **ISS Voting Policy – “Problematic Pay Practices” (current policy)**
  - Egregious employment contracts with multi-year guarantees for salary increases, non-performance based bonuses, and equity compensation
  - New CEO with overly generous new-hire package, such as excessive “make whole” provisions without sufficient rationale
  - Abnormally large bonus payouts without justifiable performance linkage or proper disclosure
  - Egregious pension/SERP payouts, such as the inclusion of additional years of service not worked that result in significant benefits provided in new arrangements or the inclusion of performance-based equity or other long-term awards in the pension calculation
  - Excessive perquisites, including perquisites for former and/or retired executives (such as lifetime benefits, car allowances, personal use of corporate aircraft, or other inappropriate arrangements), extraordinary relocation benefits, or excessive amounts of perquisite compensation
  - Excessive severance or change in control payments, including cash payments exceeding 3X base salary + bonus or payments upon an executive’s termination in connection with performance failure
  - Excise tax gross-ups in new or materially amended employment agreements
  - Tax reimbursements on perquisites or similar benefits
  - Dividend or dividend equivalents paid on unvested performance shares or units
  - Executives using company stock in hedging activities
  - Internal pay disparity
  - Repricing of options without prior stockholder approval
Managing Director Elections and Governance Process – Impact of Proxy Advisory Firms

- Understanding GRId scores
  - **Four Main Categories** – Audit, Shareholder Rights, Board Structure, and Compensation
  - Ranks company in each area as High, Medium, or Low concern
  - Several elements to GRId score in each category
  - GRId score not necessarily a direct component of voting recommendation but policy principles may overlap
  - Review scores diligently!
  - Expect update to GRId criteria and scoring in early 2012

- Glass Lewis focuses on similar principles in making its voting recommendations and issuing company proxy analysis reports

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Managing Director Elections and Governance Process – Impact of Proxy Advisory Firms

Action Items

- Sign up for free access to GRId score and proxy analysis reports
- If S&P 500, sign up for advance draft of proxy analysis report
- Verify/manage GRId score throughout year
  - Companies may submit updates/corrections anytime during year (subject to "blackout" following filing of proxy statement)
- Tell your “story” to stockholders in proxy statement
- Monitor ISS policy updates (expect November 2011 for voting policies and early 2012 for GRId criteria), particularly re: "problematic" practices
- Promptly review proxy analysis report
- Continue discussions with proxy advisory firms following proxy season
III. Stockholder Engagement
Stockholder Engagement

- Second part in webcast series to cover stockholder engagement and proxy solicitation – October 19, 2011
- Representative from Georgeson to participate
- Key topics
  - Deconstructing 2011 stockholder vote results
  - Addressing “red flags” from 2011 proxy season
  - Proactive drafting for 2012
  - Navigating proxy solicitation rules and practices
  - Understanding proxy solicitation trends
Questions?
Thank You.
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