

Client Alert

November 2011

ISS Updates its Voting Policies for the 2012 Proxy Season

Institutional Shareholder Services (“ISS”) recently announced its [updated voting policies](#) for the 2012 proxy season. The policies will become effective for shareholder meetings held on or after February 1, 2012. While the policies cover various matters, we have summarized below certain policies relating to corporate governance matters that may be of particular interest to corporations.

Proxy Access

Under new rules of the Securities and Exchange Commission (“SEC”), shareholders will be permitted to submit proxy access proposals in 2012. ISS will review such proposals on a case-by-case basis, taking into account:

- company-specific factors and
- proposal-specific factors, including
 - the ownership thresholds proposed in the resolution (i.e., percentage and duration);
 - the maximum proportion of directors that shareholders may nominate each year; and
 - the method of determining which nominations should appear on the ballot if multiple shareholders submit nominations.

The 2012 voting policies do not provide any specific guidance on what ownership thresholds or other factors would influence ISS’s recommendation.

Risk Oversight by the Board

ISS revised its policy relating to board accountability for perceived governance failures to add an explicit reference to risk oversight. As a result, ISS will, under “extraordinary circumstances,” recommend withholding or voting against individual directors, committee members, or the entire board due to (i) a material failure of governance, stewardship, risk oversight, or fiduciary responsibilities, (ii) failure to replace management as appropriate, or (iii) egregious actions related to a director’s service on other boards that raise substantial doubt about such person’s ability to effectively oversee management and serve the best interests of shareholders at any company.

Implementing the Frequency Vote on Say-on-Pay

Last year, SEC rules required issuers to hold non-binding advisory votes on the frequency with which companies would hold say-on-pay votes in the future. These “say-when-on-pay” or “frequency” votes allow shareholders to express their preference as to whether say-on-pay proposals should be considered annually, biennially, or triennially, with most shareholders voting in 2011 for annual say-on-pay proposals.

ISS will recommend a withhold/vote against all incumbent directors if the board adopts a say-on-pay vote on a less frequent basis than the frequency that received majority support from the company’s shareholders. If no frequency received majority support, ISS will assess the directors on a case-by-case basis if the board does not follow the frequency that received support from a plurality of shareholders. In doing so, ISS will consider:

- the board's rationale for selecting a frequency vote that received less than a plurality of shareholder votes;
- the company's ownership structure and vote results;
- ISS's analysis of whether there are compensation concerns or a history of problematic pay practices; and
- the previous year's support level on the company's say-on-pay proposal.

Board Responsiveness to Executive Pay

The 2012 policies indicate that, with respect to the election of compensation committee members (or, in "exceptional cases," the full board), ISS will consider those directors on a case-by-case basis if the company's prior say-on-pay vote received shareholder support of less than 70% of the votes cast. In doing so, ISS will consider the company's response to the say-on-pay vote, including disclosure of engagement with large shareholders, any specific actions taken in response to the vote, and any other recent compensation actions taken by the company. ISS will also consider the company's ownership structure and whether the company failed to receive at least 70% support due to recurring or isolated issues. The 2012 policy also indicates that a say-on-pay proposal that received less than 50% support "would warrant the highest degree of responsiveness."

It bears noting that say-on-pay proposals in 2011 were overwhelmingly approved by shareholders and received average support of approximately 92%. As of November 2011, only 44 companies failed to receive majority support. Nevertheless, ISS's decision to apply enhanced scrutiny for companies who failed to receive 70% support may generate controversy, particularly in light of the "majority rules" nature of most stockholder votes.

Exclusive Venue Proposals

Some companies have recently implemented exclusive venue provisions in their organizational documents that require shareholder litigation to be brought in a particular venue – namely, the Delaware Court of Chancery. During the 2011 proxy season, a smaller number of companies sought shareholder approval to amend their certificates of incorporation to include exclusive venue provisions. For 2012, ISS will evaluate exclusive venue proposals on a case-by-case basis, taking into account:

- whether the company has been materially harmed by shareholder litigation outside its jurisdiction of incorporation; and
- whether the company has "good governance features" (e.g., an annually elected board, a majority voting standard for director elections, and the absence of a rights plan (or poison pill), unless the rights plan was approved by shareholders).

Shareholder Proposals on Political Spending

Following the Supreme Court's 2010 decision in *Citizens United v. Federal Election Commission*, which invalidated certain political spending restrictions on unions and corporations, corporate disclosure of political spending and contributions has become a significant issue. Among other things, shareholders have submitted proposals to require such disclosure on an annual or even semi-annual basis of corporate political spending. ISS's prior policy was to evaluate such proposals on a case-by-case basis.

For the 2012 proxy season, ISS will generally recommend voting for proposals requiring greater disclosure of political contributions and similar trade association spending. The 2012 policy indicates, however, that ISS will consider the company's current disclosure policies and oversight mechanisms and any recent significant controversies, fines, or litigation involving the company's political contributions or activities. ISS also will consider on a case-by-case basis any proposals requiring information on a company's lobbying activities, including grassroots lobbying.

Executive Compensation

ISS also updated its policy relating to its evaluation of pay-for-performance. ISS refined its methodology of Russell 3000 companies to focus on “peer group alignment” and “absolute alignment.” With respect to peer group alignment, ISS will consider (i) the degree of alignment between the company’s total shareholder returns (“TSR”) rank and the CEO’s total pay rank within a peer group, as measured over one-year and three-year periods (with a 40% emphasis on the one-year period and a 60% emphasis on the three-year period), and (ii) the multiple of the CEO’s total pay relative to the peer group median. With respect to absolute alignment, ISS will review the alignment between the trend in CEO pay and company TSR over the prior five fiscal years (i.e., the difference between the trend in annual pay changes and the trend in annualized TSR during that five-year period).

Where the alignment is perceived to be unsatisfactory, ISS will analyze the following qualitative factors:

- the ratio of performance- to time-based equity awards;
- the ratio of performance-based compensation to overall compensation;
- the completeness of disclosure and rigor of performance goals;
- the company’s peer group benchmarking practices;
- actual results of financial/operational metrics, such as growth in revenue, profit, cash flow, etc., both absolute and relative to peers;
- special circumstances related to, for example, a new CEO in the prior fiscal year or anomalous equity grant practices (e.g., biennial awards); and
- any other factors deemed relevant.

If you have any questions about these or other matters of corporate law or governance, please contact Allen C. Goolsby at 804.788.8289 or agoolsby@hunton.com, Gary E. Thompson at 804.788.8787 or gthompson@hunton.com, Steven M. Haas at 804.788.7217 or shaas@hunton.com or your Hunton & Williams LLP contact.

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