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ISS RELEASES POLICY UPDATES FOR THE 2012 PROXY SEASON

On November 17, 2011, Institutional Shareholder Services Inc. (“ISS”) issued [updates](#) to its U.S. Corporate Governance Policy. These policy updates will apply to shareholder meetings held on or after February 1, 2012.

Significant policy updates include those concerning (1) board responsiveness to the results of previous say-on-pay and say-on-frequency votes, (2) revisions to ISS’ pay-for-performance methodology, (3) shareholder proxy access proposals, and (4) incentive bonus plans and Section 162(m) proposals. Each of these policy updates is discussed below in detail.

Board Responsiveness to Say-on-Pay and Say-on-Frequency

The 2011 proxy season marked the first time that all U.S. public companies were subject to a mandatory say-on-pay vote (except smaller reporting companies, which need not comply until their first shareholder meeting on or after January 21, 2013). In addition, any company subject to say-on-pay in 2011 was also required to conduct a shareholder advisory vote on how frequently it should hold a say-on-pay vote (“say-on-frequency”).

Prior Year’s Say-on-Pay Results – 70% Threshold

ISS will apply a higher level of scrutiny when determining its vote recommendations with respect to (1) any say-on-pay proposal on the ballot and (2) the re-election of each of the compensation committee members (and, in exceptional circumstances, the entire board of directors) if, in the previous year, a company’s say-on-pay proposal received the support of less than 70% of votes cast. As part of its analysis, ISS will take into account:

- the company’s response to the low level of support, including:
 - disclosure of engagement efforts with major institutional investors regarding the issues that contributed to the low level of support,
 - specific actions taken to address the issues that contributed to the low level of support, and
 - other recent compensation actions taken by the company;
- whether the issues raised are recurring or isolated;
- the company’s ownership structure; and
- whether the support level was less than 50%, which ISS believes would warrant the highest degree of responsiveness.

ISS emphasizes that companies should refrain from “boilerplate” disclosure, and that actions taken in response to low levels of support should be new actions rather than a reiteration of existing practices. Companies that received less than 70% support for their say-on-pay proposals in 2011 should engage with their major institutional investors to identify the specific areas of concern and take proactive steps to address these concerns in their compensation decisions for 2012. These companies should also ensure that their 2012 proxy disclosures thoroughly discuss these outreach efforts and



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actions. In addition to investor outreach efforts, companies should consider contacting ISS as well. Information on how companies may engage with ISS is available [here](#).

Company Response to Say-on-Pay Frequency Recommendations

ISS will recommend an “against” or “withhold” vote with regard to each incumbent director if the company’s board implements say-on-pay on a basis that is less frequent than the frequency receiving a majority of the votes cast in the most recent say-on-frequency vote.

If no frequency received a majority vote and the company’s board implements say-on-pay on a basis that is less frequent than the frequency that received a plurality of the votes cast, ISS will make a case-by-case determination of its vote recommendation for each of the company’s incumbent directors, taking into account:

- the board’s rationale;
- the company’s ownership structure and vote results;
- ISS’ analysis of whether there are compensation concerns or a history of problematic compensation practices; and
- the previous year’s support level on the company’s say-on-pay proposal.

Revisions to ISS’ Pay-for-Performance Methodology

In formulating its vote recommendations on a company’s say-on-pay proposal and re-election of compensation committee members, ISS evaluates the company’s “pay-for-performance” alignment using its own internal methodology. ISS’ current method of evaluating “pay-for-performance” for Russell 3000 companies involves determining if the company’s performance over both a one- and three-year period is in the bottom half of its Global Industry Classification Standard (“GICS”) industry group, and whether the total pay of the CEO (who has been in the position for at least two consecutive fiscal years) is aligned with shareholder performance, with particular emphasis on the last completed fiscal year.

The 2012 policy updates revise the methodology for determining “pay-for-performance” alignment in the following ways:

- ISS will use a more focused peer group comprised of 12-24 companies within the subject company’s GICS industry group with similar market capitalization and revenues, with the subject company close to the median on those measures.
- ISS will consider both peer group alignment and absolute alignment. In determining peer group alignment, ISS will evaluate both (1) the degree of alignment between the company’s Total Shareholder Return (“TSR”) rank and the CEO’s total pay rank, as measured over one-year and three-year periods within its peer group (weighted 40%/60%, respectively) and (2) the multiple of the CEO’s total pay relative to the pay of its peer group median. In determining a company’s absolute alignment, ISS will consider the difference between the trend in a company’s annual pay changes and the trend in annualized TSR over the past five fiscal years.



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If this analysis demonstrates significant long-term misalignment between pay and performance, ISS will analyze the following factors to formulate its vote recommendation:

- 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.

We expect ISS to release further guidance on its new pay-for-performance methodology before the end of 2011.

Proxy Access Proposals

The 2012 policy updates reiterate ISS' general support of proxy access as an important shareholder right, and confirm ISS' policy to make case-by-case determinations on such proposals. The 2012 policy updates, however, broaden the policy to apply to management proposals as well as shareholder proposals on proxy access, and provide that in its evaluation ISS will consider, among others factors, both "company-specific" factors and factors specific to the proposal, such as ownership thresholds proposed in the resolution, 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. ISS specifically notes that the list is not exhaustive and that "the proponent's rationale" will continue to be a factor that ISS may consider.

Incentive Bonus Plans and Section 162(m) Proposals

ISS has historically supported proposals from recent IPO companies seeking approval of equity (and cash bonus) plans for the purpose of obtaining favorable tax treatment under Section 162(m) of the Internal Revenue Code. ISS will now undertake a full equity plan evaluation of such plans, including consideration of the total shareholder value transfer in comparison to the company's allowable cap under ISS' methodology, the company's burn rate (if applicable), problematic plan provisions (such as repricing and liberal change in control provisions), and pay-for-performance (if appropriate). ISS' updated policies regarding incentive bonus plans and tax deductibility proposals provide that:

- ISS generally will recommend "for" proposals to approve or amend executive incentive bonus plans if the proposal:
 - only includes administrative features;



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- places a cap on the annual grants any one participant may receive to comply with the provisions of Section 162(m);
- adds performance goals to existing compensation plans to comply with the requirements of Section 162(m) unless they are clearly inappropriate; or
- covers cash or cash and stock bonus plans that are submitted to shareholders for the purpose of exempting compensation from taxes under the provisions of Section 162(m), provided no increase in shares is requested.
- ISS generally will recommend “against” such proposals if:
 - the compensation committee does not fully consist of independent outsiders, per ISS’ director qualifications; or
 - the plan contains excessive problematic provisions.
- ISS generally will recommend “case-by-case” on such proposals if:
 - in addition to seeking Section 162(m) tax treatment, the amendment may cause the transfer of additional shareholder value to employees; or
 - a company is presenting the plan to shareholders for Section 162(m) favorable tax treatment for the first time after the company’s IPO.

Other Policy Updates

ISS also adopted or revised the following policies:

Board Accountability and Governance Failures – ISS has added the material failure of risk oversight to the list of “material failures” that may result in a recommended “against” or “withhold” vote for individual directors, committee members, or the entire board.

Management Exclusive Venue Proposals – ISS will now make voting recommendations on a case-by-case basis on exclusive venue charter provisions proposed by management, taking into account certain enumerated factors, including whether the company has certain “good governance” features and whether the company has disclosed any “material harm” resulting from shareholder litigation outside its jurisdiction of incorporation.

Dual-Class Structure Proposals – ISS will now generally recommend a vote “against” proposals to create a new class of common stock, unless there is a compelling reason for the dual-class structure, the new class is intended for financing purposes with minimal or no dilution to current shareholders, and the new class is not designed to preserve or increase the voting power of an insider or significant shareholder.

Shareholder Proposals on Political Spending/Lobbying Activities – ISS will now generally recommend a vote “for” greater disclosure of a company’s political contributions and trade association spending and activities, and will continue to



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recommend votes on a case-by-case basis with respect to proposals requesting information on a company's lobbying activities (although the policy has been expanded to include all lobbying activities).

Other Shareholder Proposals on Social/Environmental Issues – ISS has also adopted or updated policies related to:

- its general support of proposals requesting greater disclosure of a company's natural gas hydraulic fracturing operations;
- the factors it will consider when evaluating proposals requesting disclosure regarding workplace safety and water-related risks and concerns; and
- the factors it will consider when evaluating proposals to report on current recycling programs or the adoption of new programs.

—[Kelly C. Simoneaux](#), [Hope M. Spencer](#), and [Brooke L. Longon](#)



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Remember that these legal principles may change and vary widely in their application to specific *factual circumstances*. You should consult with counsel about your individual circumstances. For further information regarding these issues, contact:

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