

DODD-FRANK'S SAY ON PAY: WILL IT LEAD TO A GREATER ROLE FOR SHAREHOLDERS IN CORPORATE GOVERNANCE?

Randall S. Thomas,[†] Alan R. Palmiter^{††} & James F. Cotter^{†††}

“Say on pay” gives shareholders an advisory vote on a company’s pay practices for its top executives. Beginning in 2011, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) mandated such votes at public companies. The first year of say on pay under the new legislation reflects a change in the dialogue and give-and-take in the shareholder–management relationship, particularly on the question of executive pay.

We study the evolution of shareholder voting on say on pay—beginning in 2006 as a fledgling shareholder movement to get say on pay on the corporate ballot; then evolving with a handful of companies and later the financial firms conducting say-on-pay votes as they received Troubled Assets Relief Program (TARP) funds; and finally leading to Dodd-Frank’s extension of the process to all public companies.

Using results from an empirical analysis of data from the pre-Dodd-Frank period, we project that the new mandatory management-sponsored say-on-pay proposals will attract strong shareholder support at most companies, while poorly performing companies with high pay levels can expect shareholder dissent. Early results in the first year post-Dodd-Frank confirm these projections.

Our empirical analysis of the pre-Dodd-Frank data supports the potential importance of third-party voting advisory recommendations—particularly those by Institutional Shareholder Services (ISS)—on executive pay proposals. The raw data show a 20% swing in shareholder support for management say-on-pay proposals associated with a negative ISS recommendation. However, once we take into account the different recommendations issued by management and ISS, the net effect of a negative ISS recommendation on the overall shareholder vote is relatively small at most companies. Nevertheless, the early Dodd-Frank results show that all thirty-seven companies that failed to obtain majority support in these advisory votes had received negative ISS recommendations.

The early results also show that companies that initially received negative say-on-pay recommendations by ISS often modified their disclosure filings

[†] John S. Beasley II Chair in Law and Business, Vanderbilt Law School, Professor of Management, Owen School of Business, Vanderbilt University.

^{††} Professor of Law, Wake Forest University School of Law.

^{†††} Thomas S. Goho Chair of Finance and Associate Professor of Finance, Wake Forest University Schools of Business.

or changed their pay practices. This may indicate a growing role for shareholders in influencing executive pay practices and corporate governance more generally.

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INTRODUCTION

For the past twenty years, executive pay in U.S. public companies has been controversial.¹ Some say it's too high and is set by captured boards.² Some say it reflects the marketplace in action.³ Some say it creates perverse (even dangerous) incentives.⁴ Some say it is being reformed and increasingly rewards the right things.⁵

With Dodd-Frank, shareholders of U.S. public corporations now also have their say. The Act mandates that public shareholders have an advisory vote on the prior year's compensation of the corporation's top five executives—a "say on pay." Looking at shareholder voting on executive pay at public companies in the eight proxy seasons preceding the enactment of Dodd-Frank, this Article asks whether the new mandatory say-on-pay regime will change executive pay levels and practices, and more generally, the dialogue between management and shareholders on the subject.

We first review the background of the debate over say on pay, as well as the enactment of the statute. We then examine shareholder votes before the enactment of Dodd-Frank on seven categories of precatory executive pay proposals submitted by shareholders under Rule 14a-8, including shareholder proposals recommending company-by-company adoption of say on pay. We find that, amongst all of these shareholder proposals, proposals requesting that shareholders approve certain pay practices, other than the overall pay levels, and proposals seeking a shareholder say on pay are the highest vote getters by a wide margin. We interpret this finding to indicate that a strong shareholder interest in providing an advisory vote on executive pay existed before the adoption of the Dodd-Frank requirements.

Continuing to examine the pre-Dodd-Frank data, we then look at how shareholders voted on shareholder proposals for say on pay

¹ See generally RESEARCH HANDBOOK ON EXECUTIVE PAY (Randall S. Thomas & Jennifer G. Hill eds., forthcoming 2012) (containing a recent compilation of articles by finance, accounting, and law professors on the topic).

² LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 30–33, 70–71 (2004).

³ See generally John E. Core, Wayne R. Guay & Randall S. Thomas, *Is U.S. CEO Compensation Inefficient Pay Without Performance?*, 103 MICH. L. REV. 1142 (2005) (reviewing BEBCHUK & FRIED, *supra* note 2) (critiquing Bebchuk and Fried's argument that executive compensation contracts are suboptimal if they reflect managerial power).

⁴ See generally Jennifer Hill & Charles M. Yablon, *Corporate Governance and Executive Remuneration: Rediscovering Managerial Positional Conflict*, 25 U. NEW S. WALES L.J. 294 (2002) (considering how positional conflicts of interest subvert goals of performance-based executive pay).

⁵ See generally Michael C. Jensen, Kevin J. Murphy & Eric G. Wruck, *Remuneration: Where We've Been, How We Got to Here, What Are the Problems, and How to Fix Them* (Eur. Corp. Governance Inst., Working Paper No. 44/2004, 2004), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=561305 (analyzing thirty-eight recommendations for reforming executive compensation).

versus management-sponsored say-on-pay proposals, which occurred in the pre-Dodd-Frank period both at the handful of companies that voluntarily instituted a say-on-pay vote and at financial institutions receiving TARP money. We find that management-sponsored say-on-pay proposals attract high levels of support on average—more than twice as much as the average for shareholder-sponsored proposals.

Looking at which proposals are most likely to attract majority-voting support, management say-on-pay proposals account for the greatest percentage by far. Of the shareholder proposals, those asking that shareholders “approve” pay practices are the most likely to attract majority support, followed by shareholder proposals seeking say-on-pay votes, and with proposals to reduce pay or link pay to performance receiving only single-digit percentage support. Based on this evidence, we project that management-sponsored say-on-pay proposals after Dodd-Frank will attract high levels of shareholder support, while only a relatively small fraction of such proposals will fail.

Turning to the influence of recommendations on shareholder voting from the Institutional Shareholder Services (ISS), our data suggest that in the pre-Dodd-Frank period a “for” ISS recommendation had approximately a 20% impact on shareholder support for most categories of executive pay proposals. This seems to be consistently true for management-sponsored say-on-pay proposals as well as most categories of shareholder-sponsored proposals. We project that this will continue in the post-Dodd-Frank period. However, once we take into account the different recommendations made by management *and* ISS, the effect of a negative ISS recommendation becomes much smaller.

We then look at the preliminary patterns identified by various sources to discuss whether shareholder voting on executive pay issues has changed with Dodd-Frank’s mandate of a shareholder say on pay. In particular, we consider whether Dodd-Frank catalyzed additional shareholder interest in executive pay issues by examining whether the post-legislation say-on-pay votes tracked, or instead varied from, past trends in shareholder activism.

Consistent with our expectations from the pre-Dodd-Frank analysis, we see that post-Dodd-Frank shareholders gave, through their say-on-pay votes, broad support to management pay packages. While this suggests that the voting gesture mandated by Dodd-Frank might be mostly empty, placement of the issue on the company’s ballot may have changed the dynamics of the shareholder–management dialogue. Poorly performing companies with high levels of executive pay often experienced greater shareholder dissatisfaction than other firms and made significant changes to their pay practices after unfavorable votes.

Moreover, during the 2011 proxy season, even before the annual meeting at which the shareholders would have their say on pay, management at a number of companies either changed the company's pay practices in response to the possibility of a failed shareholder vote or offered additional disclosure explaining pay practices that had come onto shareholder radar screens. In short, the mandate for widespread say-on-pay votes may have led management to be more responsive to shareholder concerns about executive pay and perhaps corporate governance more generally. This Article proceeds as follows. Part I looks at the evolution of say-on-pay proposals and voting before Dodd-Frank, beginning with a fledgling effort to institute company-by-company say-on-pay votes and culminating in actual say-on-pay votes at some companies that either voluntarily submitted to say on pay or did so pursuant to the federal financial bailout legislation for financial institutions receiving TARP funds.

Part II looks at the Dodd-Frank legislation and SEC rules implementing the mandate of say-on-pay votes at U.S. public companies. We consider the legislative history, as well as the SEC rulemaking, to identify the justifications (and arguments against) say on pay that emerged during congressional and agency deliberations. We also survey the academic literature that served to frame the issues—including the testable hypotheses—on the efficacy and wisdom of say on pay.

Part III explains our methodology and describes our empirical findings with data from the pre-Dodd-Frank period. Part IV offers an analysis of the preliminary results reported on voting in the post-Dodd-Frank period. Part V summarizes and concludes with some policy implications.

I

BEGINNINGS OF SAY ON PAY

Shareholder say on pay is a relatively recent phenomenon in U.S. public companies. Although say on pay has been mandated in the United Kingdom for U.K. public companies since 2003,⁶ it was not until 2006 that the first shareholder say-on-pay proposals in U.S. public companies were submitted under Rule 14a-8.⁷ Their popularity grew quickly and by 2009 they constituted the largest category of shareholder-sponsored proposals, regularly garnering majority share-

⁶ For a discussion of the arguments for and against enacting the U.K. legislation, see generally Brian R. Cheffins & Randall S. Thomas, *Should Shareholders Have a Greater Say over Executive Pay?: Learning from the US Experience*, 1 J. CORP. L. STUD. 277 (2001).

⁷ See Challie Dunn & Carol Bowie, RiskMetrics Grp., *Evaluating U.S. Company Management Say on Pay Proposals: Four Steps for Investors*, SHAREHOLDER FORUM, 4 (Mar. 16, 2009), http://www.shareholderforum.com/sop/Library/20090316_RiskMetrics.pdf.

holder support.⁸ Beginning in 2008 they had also made a foothold in corporate boardrooms, with a handful of companies voluntarily submitting their executive pay for a shareholder advisory vote.⁹

However, events soon overtook this company-by-company approach. As part of the legislative response to the financial crisis of 2008, Congress mandated that all financial firms receiving TARP funds conduct shareholder say-on-pay votes beginning in 2009.¹⁰ Then the Dodd-Frank Act extended the mandate to all U.S. public companies, with the requirement for say-on-pay votes at shareholder meetings of larger companies beginning in January 2011 and at smaller public companies beginning in 2013.¹¹

This section considers the “precocious childhood” of shareholder advisory votes on executive pay in U.S. public companies—looking first at the say-on-pay movement built on the Rule 14a-8 process and then at say on pay as required by the financial-bailout legislation.

A. Shareholder-Sponsored Say-on-Pay Proposals

The first shareholder-sponsored proposals seeking say-on-pay votes were submitted under Rule 14a-8 during the 2006 proxy season.¹² The proposals, submitted by the American Federation of State, County, and Municipal Employees (AFSCME), recommended that the corporate boards at the targeted companies give shareholders a non-binding vote on the pay of the company’s top executives.¹³

⁸ See Gary Larkin, *The Conference Bd., Say on Pay Takes Early Lead in Proxy Season Shareholder Proposal Race*, GOVERNANCE CTR. BLOG (Mar. 12, 2010), <http://tcbblogs.org/governance/2010/03/12/say-on-pay-takes-early-lead-in-proxy-season-shareholder-proposal-race> (reporting that during the 2009 proxy season there were 255 say-on-pay proposals that received more than 59% shareholder support).

⁹ Dunn & Bowie, *supra* note 7, at 10 (summarizing management-submitted say-on-pay votes during the 2008 proxy season at nine companies, with only one company receiving less than 90% shareholder support).

¹⁰ See American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 111(e), 123 Stat. 115, 519.

¹¹ See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 951, 124 Stat. 1899 (2010) (to be codified in scattered sections of U.S.C.).

¹² See Dunn & Bowie, *supra* note 7, at 4.

¹³ See M&A Commentary—“Say on Pay” Shareholder Advisory Votes on Executive Compensation: *The New Frontier of Corporate Governance Activism*, LATHAM & WATKINS LLP, 2 (Nov. 2007), http://www.lw.com/upload/pubContent/_pdf/pub2039_1.pdf. In 2007, the SEC accepted that shareholder say-on-pay proposals were not per se excludable under Rule 14a-8. See *Affiliated Computer Services, Inc.*, SEC No-Action Letter, 2007 SEC No-Act. LEXIS 397 (Mar. 27, 2007); *Burlington N. Santa Fe Corp.*, SEC No-Action Letter, 2008 WL 203713 (Jan. 22, 2008); see also *Proposals on Policy for ‘Advisory’ Votes Regarding Executive Pay Not Excludable*, 39 Sec. Reg. & L. Rep. (BNA) 370 (Mar. 5, 2007) (reviewing three no-action responses in which SEC staff advised AT&T Inc., Qwest Communications International Inc., and Clear Channel Communications Inc. that shareholder say-on-pay proposals are not excludable).

These early Rule 14a-8 say-on-pay proposals followed a relatively fixed formula, with shareholder proponents seeking shareholder support with a resolution as follows:

RESOLVED, that stockholders of [Company] urge the board of directors to adopt a policy that [Company] stockholders be given the opportunity at each annual meeting of stockholders to vote on an advisory resolution, to be proposed by [Company's] management, to approve the report of the . . . Compensation Committee set forth in the proxy statement. The policy should provide that appropriate disclosures will be made to ensure that stockholders fully understand that the vote is advisory; will not affect any person's compensation; and will not affect the approval of any compensation-related proposal submitted for a vote of stockholders at the same or any other meeting of stockholders.¹⁴

As we show in Part III, these 14a-8 say-on-pay shareholder proposals received significant shareholder support, despite uniform manage-

¹⁴ See The Home Depot Inc., Definitive Proxy Statement (Schedule 14A), at 11 (Apr. 14, 2006), available at <http://www.sec.gov/Archives/edgar/data/354950/000104746906005182/a2168590zdef14a.htm>. The accompanying supporting statement explained:

In our view, senior executive compensation at Home Depot has been excessive in recent years. In each of the last three years, CEO Robert Nardelli has been paid a base salary of more than \$1,800,000, well in excess of the IRS cap for deductibility of non-performance-based compensation. His bonus in each of those years has been at least \$4,000,000, and he was awarded restricted stock valued at over \$8,000,000 in 2002, 2003 and 2004. Mr. Nardelli has also received a disturbingly large amount of compensation in form of "loan forgiveness" and tax gross-ups related to that forgiveness, which totaled over \$3,000,000 in each of the past three years.

We believe that the current rules governing senior executive compensation do not give stockholders enough influence over pay practices. In the United Kingdom, public companies allow stockholders to cast an advisory vote on the "directors' remuneration report." Such a vote isn't binding, but allows stockholders a clear voice which could help reduce excessive pay. U.S. stock exchange listing standards do require shareholder approval of equity-based compensation plans; those plans, however, set general parameters and accord the compensation committee substantial discretion in making awards and establishing performance thresholds for a particular year. Stockholders do not have any mechanism for providing ongoing input on the application of those general standards to individual pay packages. . . .

Similarly, performance criteria submitted for stockholder approval to allow a company to deduct compensation in excess of \$1 million are also broad and do not constrain compensation committees in setting performance targets for particular executives. Withholding votes from compensation committee members who are standing for reelection is a blunt instrument for registering dissatisfaction with the way in which the committee has administered compensation plans and policies in the previous year.

Accordingly, we urge Home Depot's board to allow stockholders to express their opinion about senior executive compensation practices by establishing an annual referendum process. The results of such a vote would, we think, provide Home Depot with useful information about whether stockholders view the company's compensation practices, as reported each year in the Leadership Development and Compensation Committee Report, to be in stockholders' best interests.

We urge stockholders to vote for this proposal.

ment hostility.¹⁵ Management opposed the proposals on the ground that the board of directors is charged by corporate law and stock exchange rules with setting the terms of pay for the company's top executives. Shareholder input, it was said, would diminish the effectiveness of the board's role. A typical response, like the one here by Home Depot, went as follows:

The Company believes that an advisory resolution would not change the contents of the Committee's [detailed compensation discussion and analysis] report nor have any legal consequence on any compensation arrangement. Most importantly, an advisory vote would not provide the Committee with any meaningful insight into specific shareholder concerns regarding executive compensation that it could address when considering the Company's remuneration policies. Finally, an advisory vote is impractical when more effective means of communicating concerns to the Committee are available to shareholders.¹⁶

Although boards at first ignored say-on-pay proposals, even when approved by a shareholder majority,¹⁷ within a few years, as we discuss in Part III, some companies began voluntarily to hold advisory say-on-pay votes.¹⁸

Beginning in 2008, ISS took the position that shareholders should generally vote for shareholder-sponsored say-on-pay proposals that call on management to submit the pay of top executives to a non-binding shareholder vote.¹⁹ As for management-sponsored say-on-pay proposals, ISS urged for the 2008 proxy season a case-by-case approach and called for an "against" vote when "boards have failed to demonstrate good stewardship of investors' interests regarding executive compensation practices."²⁰ ISS identified five principles to apply: (1) "pay-for-performance alignment"; (2) avoid "pay for failure"; (3) maintain an effective compensation committee; (4) provide clear,

¹⁵ See *infra* notes 132–41 and accompanying text.

¹⁶ The Home Depot, Inc., *supra* note 14, at 12.

¹⁷ See Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 1012 (2010).

¹⁸ *Id.* at 1036 (describing say-on-pay votes at Aflac in 2008 and similar votes in 2009 at Verizon, Blockbuster, Occidental Petroleum, Intel, Hewlett-Packard, MBIA, Motorola, and Ingersoll Rand).

¹⁹ The first ISS recommendation addressing shareholder-submitted say on pay came in 2008. See ISS GOVERNANCE SERVS., 2008 U.S. Proxy Voting Guidelines Summary 40 (2007), available at <http://www.usbank.com/pcg/pdf/US2008SummaryGuidelines.pdf> [hereinafter ISS 2008 GUIDELINES]. Before 2008, the ISS voting guidelines took no position on say-on-pay proposals. See generally ISS GOVERNANCE SERVS., CONCISE SUMMARY OF ISS 2007 PROXY VOTING GUIDELINES (2006), available at www.foxbycorp.com/PDF/2007SummaryPolicy.pdf.

²⁰ ISS 2008 GUIDELINES, *supra* note 19, at 35; ISS GOVERNANCE SERVS., U.S. PROXY VOTING GUIDELINES CONCISE SUMMARY 11 (2009), available at <https://www.vcim.ca/pdfs/2008USConciseSummaryGuidelines.pdf>.

comprehensive pay disclosure; and (5) “[a]void inappropriate pay to non-executive directors.”²¹

B. Effects of Shareholder-Sponsored Pay Proposals

Shareholder interest during the late 2000s in the early say-on-pay movement coincided with a trend of growing interest by shareholders in executive pay issues. In the mid-1990s, shareholders had voted on a variety of shareholder-sponsored proposals on executive pay but generally with relatively low levels of shareholder support.²² Then in the mid-2000s, shareholder activists began to target companies with high pay levels, resulting in higher levels of shareholder support and company implementation.²³

An early study by Thomas and Martin of executive compensation shareholder proposals from the mid-1990s found seven major categories of shareholder pay proposals: reports to shareholders prepared by management or committees of directors to review executive pay practices, increased disclosure about pay levels and practices, shareholder approval for specified payments to executives, caps on the amounts of executive pay awarded without investor approval, links between pay and performance, reductions in the use of certain types of pay, and restrictions on total annual executive pay.²⁴ Typically, these shareholder-sponsored proposals were targeted at relatively poor-performing companies with higher levels of pay, but generally received lower levels of voting support than other types of shareholder proposals seeking corporate governance reforms.²⁵ However, Thomas and Martin found that when proposals received higher levels of support, targeted firms significantly reduced the rate of increase of executive pay over the two-year period following a well-supported proposal.²⁶

A more recent study by Ertimur, Ferri, and Muslu of shareholder-sponsored executive pay proposals from 1997 to 2007 found that activists target companies with high executive pay.²⁷ They also concluded that shareholder support levels were higher at firms with “excess” CEO pay.²⁸ They found that shareholders prefer proposals that relate to the pay-setting process, such as requirements to submit pay for

²¹ ISS 2008 GUIDELINES, *supra* note 19, at 35.

²² See Randall S. Thomas & Kenneth J. Martin, *The Effect of Shareholder Proposals on Executive Compensation*, 67 U. CIN. L. REV. 1021, 1046 (1999) (noting that in 1994, shareholder-sponsored executive compensation proposals received favorable votes in only 12.8% of cases).

²³ See Yonca Ertimur, Fabrizio Ferri & Volkan Muslu, *Shareholder Activism and CEO Pay*, 24 REV. FIN. STUD. 535, 576 (2011).

²⁴ See Thomas & Martin, *supra* note 22, at 1073.

²⁵ See *id.* at 1021–22.

²⁶ See *id.* at 1066–67.

²⁷ See Ertimur, Ferri & Muslu, *supra* note 23, at 576.

²⁸ *Id.*

shareholder approval, and that such proposals were more likely to be implemented.²⁹ Targeted firms whose CEOs' pay was "excessive" subsequently reduced CEO pay substantially.³⁰

Both of these studies suggest that a say-on-pay vote—as mandated by Dodd-Frank—would allow shareholders to signal their discontent with pay practices at particular companies, which could well lead to company pay reforms. A common finding of the studies is that proposals that receive more shareholder support are more likely to result in changes at targeted firms, especially in CEO-pay reductions and, in the later study, changes to pay practices as well. This suggests that giving shareholders a say-on-pay vote could have similar effects, particularly when shareholders have signaled their dissatisfaction with company pay levels or practices.

A third study by Cai and Walking adds further clarity to the picture.³¹ The authors conducted an event study on the stock market reaction to the enactment of say-on-pay legislation and found a statistically significant positive market reaction for firms with abnormally high levels of CEO pay and low pay-for-performance sensitivity.³² However, looking at pay proposals from 2006 to 2008, they found that the pay proposals were targeted at companies without those characteristics and that the market responded favorably to their defeat.³³ They concluded that say-on-pay votes might create value for companies with inefficient compensation structures but not for other firms.³⁴

C. Mandatory Say on Pay for TARP Recipients

The financial crisis of 2008 moved say on pay from the activist shareholder toolbox to the legislative agenda. Responding to the public outcry that federal bailout funds were being used to pay executive bonuses, the Emergency Economic Stabilization Act of 2008 (EESA) required that financial firms receiving TARP funds give their shareholders an advisory vote on executive pay.³⁵ The American Recovery and Reinvestment Act of 2009 (the financial stimulus plan) also imposed the say-on-pay requirement for financial firms that had outstanding TARP debts.³⁶

²⁹ *Id.* at 574.

³⁰ *Id.*

³¹ Jie Cai & Ralph A. Walking, *Shareholders' Say on Pay: Does It Create Value?*, J. FIN. & QUANTITATIVE ANALYSIS (forthcoming), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1030925.

³² *Id.* (manuscript at 1).

³³ *Id.* (manuscript at 5).

³⁴ *Id.* (manuscript at 6).

³⁵ 12 U.S.C. § 5221(e) (2006).

³⁶ See Pub. L. No. 111-5, § 111(e), 123 Stat. 115, 519. Thus, financial companies with outstanding TARP funds are required to submit executive pay to a shareholder vote under both TARP and Dodd-Frank. The SEC has made clear that only one vote, however, is

In 2009, the SEC adopted rules for say on pay at TARP-funded firms.³⁷ The SEC amended its proxy rules to require TARP recipients to permit a separate shareholder advisory vote on the firm's executive pay, as disclosed under the SEC proxy rules. The SEC did not take a position on the utility of the say-on-pay vote but explained it was simply implementing the congressional say-on-pay mandate. All told, about 280 financial firms that received TARP funds held say-on-pay votes during the 2010 proxy season.³⁸

The EESA mandate of say on pay for financial firms receiving TARP money expanded the shareholder say-on-pay movement, which had already targeted pay practices at certain financial services firms. Unlike a vote "for" a shareholder 14a-8 proposal requesting the company board to implement a shareholder vote on compensation practices (which generally reflected dissatisfaction with existing pay practices or levels), these new mandatory management-sponsored proposals asked shareholders to vote in favor of approving current pay practices. Thus, a higher "for" vote on a management-sponsored say-on-pay proposal reflects greater shareholder support for the company's existing pay regime.

Voting advisors continued to play an important role with these new proposals. In 2010, when say-on-pay became mandatory at TARP-funded firms, ISS changed its approach and focused its guidelines on management-sponsored say-on-pay proposals. The ISS proxy-voting guidelines no longer simply identified voting principles, but called for an "against" vote on management say-on-pay proposals if there was: (1) "a misalignment between CEO pay and company performance"; (2) "problematic pay practices"; or (3) "poor communication and responsiveness [by the board] to shareholders."³⁹ The 2010 guidelines

necessary to satisfy both statutory requirements. *See* Shareholder Approval of Executive Compensation and Golden Parachute Compensation, Securities Act Release No. 9178, Exchange Act Release No. 63,768, 2011 WL 231597, at *25 (Jan. 25, 2011) [hereinafter SEC Executive Compensation Release] (noting that the vote under EESA is "effectively" the same as required by Dodd-Frank). Given that TARP recipients are required to conduct a say-on-pay vote annually, the SEC has exempted such firms from a vote on the frequency of say on pay. *See id.* at 57–58 (discussing the exemption from Rule 14a-21(b), 17 C.F.R. § 240.14a-21(b) (2011)).

³⁷ *See* Shareholder Approval of Executive Compensation of TARP Recipients, Exchange Act Release No. 61,335, 75 Fed. Reg. 2789-01 (Jan. 19, 2010) [hereinafter SEC TARP Release] (adopting Rule 14a-20, § 240.14a-20, which requires that TARP recipients provide a separate nonbinding shareholder vote to approve compensation of executives whenever shareholders vote at an annual meeting involving election of directors).

³⁸ Scott Hirst, *The 2010 Proxy Season: A Brave New World*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Sept. 7, 2010, 9:13 AM), <http://blogs.law.harvard.edu/corpgov/2010/09/07/the-2010-proxy-season-a-brave-new-world> (posting of material prepared by David Drake).

³⁹ ISS GOVERNANCE SERVS., U.S. PROXY VOTING GUIDELINES CONCISE SUMMARY 11–12 (2010), available at <http://www.westcore.com/Misc/~~/media/Files/Westcore/2010%20US%20Policy%20Concise%20Summary%20Guidelinesrevised.ashx>.

also made the “management say on pay (MSOP) ballot item” the primary focus of voting on executive pay practices, stating that “dissatisfaction with compensation practices can be expressed by voting against the MSOP rather than withholding or voting against the compensation committee.”⁴⁰

The EESA mandate expanded the pool of firms subject to advisory say-on-pay votes beyond those targeted by shareholders as having “bad” compensation practices, and so it was predictable that shareholder voting support in 2010 for say-on-pay proposals increased. In fact, during the 2010 proxy season, our pre-Dodd-Frank analysis shows that shareholders at TARP-funded firms on average voted 88.7% in support of management-sponsored say-on-pay proposals.⁴¹ This is interesting given that most mandatory say-on-pay votes in 2010 were held largely at financial firms receiving TARP money where one might have expected shareholders to be more skeptical of executive pay practices.

II

DODD-FRANK SAY-ON-PAY MANDATE

A. Legislative Mandate

Section 951 of Dodd-Frank requires public companies to give their shareholders an advisory vote to approve or disapprove of the compensation paid to named executives during the prior fiscal year.⁴² Dodd-Frank also requires an advisory vote by shareholders on how frequently the say-on-pay vote is to occur and on golden-parachute payments in any acquisition or merger.⁴³ None of these votes, however, is to carry any mandatory force or change directors’ duties to shareholders; thus, Dodd-Frank makes clear that any shareholder vote should not be construed to overrule any decision by the company or its board, or to imply any additional fiduciary duties.⁴⁴

Dodd-Frank requires that management present “a separate resolution subject to shareholder vote to approve the compensation of executives,” though the vote “shall not be binding on the issuer or the board of directors.”⁴⁵ The inclusion by management of a say-on-pay proposal does not limit the ability of shareholders to make their own

⁴⁰ *Id.* at 11.

⁴¹ *See infra* Part III.A.2.

⁴² Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 951, 124 Stat. 1375, 1899 (2010) (adding new section 14A to the Securities Exchange Act of 1934).

⁴³ *Id.* (codified at 15 U.S.C. § 78n-1(a), (b) (Supp. IV 2010)).

⁴⁴ *Id.* (codified at 15 U.S.C. § 78n-1(c)(1)–(c)(3)).

⁴⁵ *Id.* (codified at 15 U.S.C. § 78n-1(a)(1), (c)). In addition, affected companies must hold an advisory vote at least every six years on whether the say-on-pay vote will occur every one, two, or three years. *Id.* (codified at 15 U.S.C. § 78n-1(a)(2)).

proposals “for inclusion in the proxy materials related to executive compensation.”⁴⁶

B. Implementing SEC Rules

The SEC implemented section 951 of Dodd-Frank with detailed requirements that specify the form of the say-on-pay proposal and the executive officers whose pay is subject to a shareholder vote. The SEC required say-on-pay votes at public companies with more than \$75 million in a public equity float beginning with shareholder meetings held after January 21, 2011.⁴⁷

The say-on-pay vote applies only to the company’s CEO and the four other executive officers named in the company’s proxy compensation table.⁴⁸ The vote relates to the compensation disclosed in the proxy statement as described in the “Compensation Discussion and Analysis” (CD&A).⁴⁹ The vote is up or down as to the overall compensation package and not as to the specific elements of compensation (such as bonuses, stock options, retirement pay, and performance incentives).⁵⁰

The results of the say-on-pay vote must be disclosed on Form 8-K within four business days after the shareholders’ meeting.⁵¹ In addition, the company must disclose, in the next year’s CD&A, whether

⁴⁶ *Id.* (codified at 15 U.S.C. § 78n-1(c)(4)).

⁴⁷ SEC Executive Compensation Release, *supra* note 36, at *1, *48. Smaller reporting companies become subject to the say-on-pay voting requirement for annual meetings after January 21, 2013. *Id.* at *1.

⁴⁸ See 17 C.F.R. § 240.14a-21(a) (2011) (requiring a say-on-pay vote, at annual shareholder meetings at which directors are elected, for named executives whose compensation is disclosed pursuant to Item 402 of Regulation S-K). The compensation of directors is not subject to a mandatory say-on-pay vote. See SEC TARP Release, *supra* note 37, at *9.

⁴⁹ The SEC rule does not require that the management-submitted say-on-pay proposal be phrased in a particular way, though it must indicate that the proposal seeks a shareholder vote “to approve the compensation of executives as disclosed pursuant to [Item 402 of Regulation S-K].” SEC TARP Release, *supra* note 37, at *9 (alterations in original) (quoting Securities Exchange Act of 1934 § 14A(a)(1), 15 U.S.C. 78n-1(a)(1) (2006 & Supp. IV 2010)). A suggested proposal calls on shareholders to approve “compensation paid . . . as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion.” *Id.* at *9 n.68. A vote to approve only compensation policies and procedures would not pass muster. *Id.* at *9–10.

⁵⁰ See 17 C.F.R. § 240.14a-21(a). In addition, the SEC added a comment to Rule 14a-8 that companies will be allowed to exclude shareholder-submitted proposals under the rule if the shareholder proposes a say-on-pay vote with “substantially the same scope as the say-on-pay vote required by Rule 14a-21(a).” SEC Executive Compensation Release, *supra* note 36, at *21.

⁵¹ See SEC Form 8-K, Item 5.07; see also SEC Executive Compensation Release, *supra* note 36, at *23 (changing disclosure on shareholder vote on say-on-pay frequency but not shareholder votes on say-on-pay resolution).

and how the board considered the results of the shareholder say-on-pay vote in making any decisions.⁵²

In implementing the say-on-pay mandate of Dodd-Frank, the SEC did not consider the usefulness of the vote. Nor did the agency speculate on how say on pay would affect pay practices or levels. Those matters, in effect, had already been considered in the debate we summarize below.

C. Debate over Mandatory Say on Pay

Even before Congress enacted its say-on-pay mandate in Dodd-Frank, an active academic debate emerged on whether a federally mandated shareholder vote on executive pay was a good idea and whether it could be effective. The academic debate on say on pay mirrored in many ways the basic debate of whether mandatory corporate law—particularly at the federal level—should displace enabling state law. That is, say on pay raised the question whether a mandatory shareholder role in executive pay held uniformly across all public companies was preferable to a voluntary company-by-company approach permitted by state law and facilitated by shareholder proposals under the process specified in Rule 14a-8.

In the end, the debate revealed a host of questions and supposed answers on what say on pay would produce. Sometimes the answers stemmed from different attitudes about whether and how executive pay was a problem in U.S. corporations; at other times the answers reflected varying philosophies toward the role of shareholder voting in U.S. corporations; and yet at other times the answers looked at the existing evidence on say on pay but still reached opposite conclusions.

1. *Lessons from U.K. Experience*

Much of the academic debate has hinged on the U.K. experience with say on pay for U.K. listed companies. In 2002, the United Kingdom became the first country to enact legislation mandating a shareholder vote on executive pay.⁵³ The legislation required U.K.-incorporated listed companies to submit a “Director’s Remuneration Report” annually to shareholders and to hold a nonbinding shareholder advisory vote on that report.⁵⁴ The U.K. say-on-pay mandate

⁵² See SEC Executive Compensation Release, *supra* note 36, at *11 (amending Item 402(b)(1) to disclose how a company “considered the results of previous shareholder [say-on-pay] votes . . . in determining compensation policies and decisions and, if so, how that consideration has affected its compensation policies and decisions”). The disclosure is limited to the company’s response to the most recent say-on-pay vote. See *id.* at *12–13.

⁵³ Steven Deane, *Say on Pay: Results from Overseas*, CORP. BD., Jul.–Aug. 2007, at 11, 11–12.

⁵⁴ Sudhakar Balachandran, Fabrizio Ferri & David Maber, Solving the Executive Compensation Problem Through Shareholder Votes? Evidence from the U.K. 6 (Nov. 2007)

sought to address concerns among the public and institutional investors about excessive executive pay.⁵⁵

Other countries followed suit, with Australia and the Netherlands enacting say-on-pay legislation in 2004.⁵⁶ The Dutch law calls for a binding shareholder vote, not merely an advisory one, but the vote does not necessarily happen annually, and the shareholder vote concerns compensation policies, not a retrospective pay report.⁵⁷ Following the Dutch model, Sweden in 2006 and Norway in 2007 also enacted legislation requiring a binding shareholder vote on compensation policies.⁵⁸

In testimony before the Senate committee considering what would become Dodd-Frank, Professor John Coates concluded that the U.K.'s experience had been positive:

Different researchers have conducted several investigations [on the U.K. say-on-pay experience] . . . [T]hese findings suggest that "say-on-pay" legislation would have a positive impact on corporate governance in the U.S. While the two legal contexts are not identical, there is no evidence in the existing literature to suggest that the differences would turn what would be a good idea in the U.K. into a bad one in the U.S.⁵⁹

Coates's testimony drew principally from a study by Fabrizio Ferri and David Maber, comparing U.K. pay practices before and after the U.K. say-on-pay mandate.⁶⁰ Ferri and Maber, examining the impact of the U.K. legislation on stock prices in high-pay companies and actual voting results under the U.K. say-on-pay regime, identified a favorable shareholder reaction to the legislation and pay reforms at companies receiving negative votes on their pay practices:

We examine the effect of say on pay regulation in the United Kingdom (UK). Consistent with the view that shareholders regard say on pay as a value-creating mechanism, the regulation's announcement triggered a positive stock price reaction at firms with weak penalties for poor performance. UK firms responded to negative

(unpublished manuscript), available at http://www7.gsb.columbia.edu/ciber/sites/default/files/balchandranCIBER_Grant_Paper_UK_Voting.pdf.

⁵⁵ *Id.*

⁵⁶ Deane, *supra* note 53, at 12.

⁵⁷ See Regan Adamson & Daniel Lumm, *Shareholder Democracy and the Say on Pay Movement: Progress, But How Do You Define Success?* 6 (Wake Forest L. Rev. Working Paper Series, 2009).

⁵⁸ *Id.*

⁵⁹ See *Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance: Hearing Before the Subcomm. on Sec., Ins., & Inv. of the S. Comm. on Banking, Hous., and Urban Affairs*, 111th Cong. 47 (2009) (prepared statement of John C. Coates IV, John F. Cogan, Jr. Professor of Law and Economics, Harvard Law School), available at <http://www.gpo.gov/fdsys/pkg/CHRG-111shrg55479/pdf/CHRG-111shrg55479.pdf>.

⁶⁰ *See id.*

say on pay voting outcomes by removing controversial CEO pay practices criticized as rewards for failure (e.g., generous severance contracts) and increasing the sensitivity of pay to poor realizations of performance.⁶¹

In a previous study, Ferri and Maber, along with Sudhakar Balachandran, also concluded that the new rule had increased pay-for-performance sensitivity at U.K. companies:

Based on a large sample of UK firms over the period from 2000 to 2005, we find evidence of enhanced sensitivity of CEO cash compensation to negative operating performance and enhanced sensitivity of CEO total compensation to negative operating and stock performance after the new rule, consistent with widespread calls for less “rewards for failure” that had led to its introduction.⁶²

2. *Academic Debate over Say on Pay*

The academic debate on say on pay predating Dodd-Frank largely accepted that even an advisory shareholder vote on corporate pay practices would alter the shareholder role in corporate governance. Views varied along ideological lines, with academics who rued the rise of shareholder activism concluding that say on pay would undermine the efficiency of a “board centrism,” while academics who supported a move toward shareholder primacy seeing say on pay as a natural step in that direction. These issues and the respective academics’ positions are summarized below.

a. *Shift in Corporate Balance of Power?*

Academic proponents of say on pay anticipated more transparency and accountability in the corporation and thus presumably greater efficiency and social responsiveness. These proponents argued that say on pay would help boards overcome psychological barriers and negotiate pay packages with CEOs more effectively on behalf of shareholders.⁶³

Academic skeptics of say on pay saw a federally mandated shareholder vote on executive pay—whether advisory or binding—as upset-

⁶¹ Fabrizio Ferri & David A. Maber, *Say on Pay Votes and CEO Compensation: Evidence from the UK*, REV. FIN. (forthcoming) (manuscript abstract), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1420394 (last updated Nov. 25, 2011).

⁶² Balachandran, Ferri & Maber, *supra* note 54, at 1.

⁶³ See *Empowering Shareholders on Executive Compensation: Hearing on H.R. 1257 Before the H. Comm. on Fin. Servs.*, 110th Cong. 68 (2007) (written testimony of Lucian A. Bebchuk, William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics, and Finance, Harvard Law School) [hereinafter *Bebchuk Testimony*], available at <http://www.gpo.gov/fdsys/pkg/CHRG-110hhrg35402/pdf/CHRG-110hhrg35402.pdf>; Draft Policy Briefing, Stephen Davis, *Does ‘Say on Pay’ Work? Lessons on Making CEO Compensation Accountable* (Millstein Ctr. for Corp. Governance & Performance, Yale Sch. of Mgmt., New Haven, C.T.), 2007, at 7–8.

ting the balance of authority between the corporate board and shareholders. Professor Steven Bainbridge, for example, argued that say on pay would “shift power from boards of directors not to shareholders but to advisory firms” that both advise and rate companies on corporate governance matters.⁶⁴

Others pointed out that a mandatory say-on-pay vote is unnecessary, as shareholders could already express their concerns about executive pay—through dialogue with management, with the casting of “no” or “withhold” votes on directors sitting on underperforming compensation committees, and with shareholder proposals seeking company-by-company say-on-pay votes.⁶⁵

Along this skeptical line of inquiry, some scholars predicted that the mandatory vote would create few benefits—as it was already possible for shareholders to seek such a vote prior to Dodd-Frank—and was certain to produce additional costs. In comments on an early say-on-pay bill, Professor Steven Kaplan stated:

In contrast, H.R. 1257 would mandate a non-binding shareholder vote to approve the compensation of executives for every company every year. Companies with problems will have a vote and, presumably, will receive a negative vote. But this is almost exactly what happens under the current system. So, it is not clear to me that the new bill would create any benefits.⁶⁶

Kaplan further argued that “increased transparency for CEO pay required by the new SEC disclosure rules should further reduce any remaining unwise compensation practices.”⁶⁷

b. *Shareholders Lack Focus on Say on Pay?*

Supporters of say on pay assumed shareholders would do their homework, would be able to discern poorly designed pay packages, and would be emboldened to vote against them.⁶⁸ If they needed

⁶⁴ See Stephen M. Bainbridge, *The Corporate Governance Provisions of Dodd-Frank 4* (UCLA Sch. L. Law-Econ Research Paper No. 10-14, Oct. 27, 2010), available at <http://ssrn.com/abstract=1698898>.

⁶⁵ See Letter from Timothy J. Bartl, Senior Vice President & Gen. Counsel, Ctr. on Exec. Comp., to Elizabeth M. Murphy, Sec’y, SEC (Sept. 8, 2009), available at www.sec.gov/comments/s7-12-09/s71209-46.pdf.

⁶⁶ *Empowering Shareholders on Executive Compensation: Hearing on H.R. 1257 Before the H. Comm. on Fin. Servs.*, 110th Cong. 126 (testimony of Steven N. Kaplan, Neubauer Family Professor of Entrepreneurship and Finance, University of Chicago) [hereinafter Kaplan Testimony], available at <http://www.gpo.gov/fdsys/pkg/CHRG-110hhrg35402/pdf/CHRG-110hhrg35402.pdf>.

⁶⁷ *Id.* at 121.

⁶⁸ Bebchuk Testimony, *supra* note 63, at 65–66 (concluding that say-on-pay votes “will annually provide companies with valuable information about how their shareholders view company performance in this critical test”).

help, ISS and the other proxy advisory firms would be there to provide it.

Critics, however, questioned whether shareholders would be able to discern differences in pay plans. Professor Jeffrey Gordon doubted the likelihood of shareholder interest, pointing to the U.K. experience, where shareholders had invariably approved pay packages put to a vote—with only eight negative votes in the first six years of the U.K. experience with say on pay.⁶⁹

Gordon argued that it was unlikely that U.S. shareholders would give individualized attention to compensation schemes at the thousands of U.S. public companies.⁷⁰ In addition, he looked at the first couple of years of experience with say-on-pay shareholder proposals and concluded that say on pay had not been embraced by shareholders.⁷¹

Gordon further noted that the number of shareholder say-on-pay proposals had been relatively constant.⁷² Moreover, overall shareholder support had leveled off at about 42%, suggesting that most shareholders were not taken by the concept.⁷³ Repeating this point in congressional testimony, Professor J.W. Verret noted that most shareholders have voted against shareholder say-on-pay proposals:

Just last year, seven[ty] proposals for say-on-pay were introduced at companies in 2008, ten of them were successful.

The average vote was a 60 percent vote against say-on-pay by the shareholders. At financial companies it is even higher. 70 percent was the average vote against say-on-pay at financial companies. So shareholders . . . at the majority of companies in a very strong majority way have expressed dissatisfaction with say-on-pay proposals.⁷⁴

Some critics also predicted that some shareholders would use say-on-pay to advance political agendas. In testimony before Congress in 2007, Kaplan predicted:

At the same time, the [say-on-pay] bill would mandate a vote for companies that do not have a problem. This . . . potentially subjects

⁶⁹ Jeffrey N. Gordon, “Say on Pay”: *Cautionary Notes on the U.K. Experience and the Case for Shareholder Opt-In*, 46 HARV. J. ON LEGIS. 323, 341 (2009) (explaining that “shareholders invariably approve the Directors Remuneration Report, with perhaps eight turndowns across thousands of votes over a six-year experience”).

⁷⁰ See *id.* at 351.

⁷¹ See *id.* at 339 (“The number of [say-on-pay] proposals grew only moderately [in 2008], to seventy, and the level of shareholder support has remained at the same level, approximately forty-two percent.”).

⁷² See *id.*

⁷³ *Id.*

⁷⁴ *Compensation Structure and Systemic Risk: Hearing Before the H. Comm. on Fin. Servs.*, 111th Cong. 52–53 (2009) (statement of J.W. Verret, Assistant Professor, George Mason Univ. Sch. L.) [hereinafter Verret Testimony], available at <http://www.gpo.gov/fdsys/pkg/CHRG-111hhrg52398/pdf/CHRG-111hhrg52398.pdf>.

these boards and companies to increased pressure from interest groups that they do not incur today. One can imagine politically oriented shareholders attempting to make political statements in their votes.⁷⁵

The empirical evidence on this point, though, is mixed.⁷⁶

c. *Increased Sway of Proxy Advisory Firms?*

Some skeptics commented that say on pay would only increase the power of proxy advisory firms, whose purportedly one-size-fits-all recommendations would be followed blindly by institutional shareholders.⁷⁷ These critics argued that management will thus become manacled by shareholders, undermining their discretionary authority.⁷⁸ The critics also were concerned that ISS recommendations could be biased since the firm both provides voting advice on pay packages and consults with companies on adopting pay policies.⁷⁹

Similarly, Gordon predicted that institutional shareholders would rely on proxy advisory firms, which would wield undue influence over voting on executive pay.⁸⁰ Gordon further predicted that activist shareholders would focus only selectively on a narrow range of compensation schemes, namely those identified as problematic by proxy advisory firms.

In this same vein, Verret stated in congressional testimony:

[W]e have seen in Britain . . . that concentration of the proxy advisory firms has caused sort of a one-size-fits-all solution to take hold in pay. I think it is better to have a flexible approach, that compensation committees should have the flexibility to design compensation proposals appropriate for their own businesses.⁸¹

Nonetheless, ISS (and other proxy advisory firms) may serve the purpose of helping shareholders, particularly institutional sharehold-

⁷⁵ Kaplan Testimony, *supra* note 66, at 126.

⁷⁶ Compare Cai & Walking, *supra* note 31, at 32–33 (finding negative market reaction to pay proposals sponsored by labor unions) with Ertimur, Ferri & Muslu, *supra* note 23, at 2–3 (finding that unions are not more likely to target firms that are unionized or engaged in disputes with unions). See generally Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018 (1998) (discussing labor union shareholder activism).

⁷⁷ See, e.g., Bainbridge, *supra* note 64, at 4–5 (arguing that RiskMetrics, the most important proxy advisory firm, faces conflicts arising from its dual roles in advising and rating companies on corporate governance matters).

⁷⁸ See Stephen N. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779, 1815 (2011).

⁷⁹ See CENTER ON EXEC. COMP., A CALL FOR CHANGE IN THE PROXY ADVISORY INDUSTRY STATUS QUO 7–8 (2011), available at http://www.execcomp.org/docs/c11-07a%20Proxy%20Advisory%20White%20Paper%20_FULL%20COLOR_.pdf.

⁸⁰ See Gordon, *supra* note 69, at 351–52.

⁸¹ Verret Testimony, *supra* note 74, at 68.

ers, collectivize and use their voting power in a coordinated way.⁸² For example, Professor Lynn Stout has pointed out that “[w]hen institutional investors follow ISS [vote recommendations] en masse, directors of public corporations can expect to see 20%, 30% even 50% of their company’s shares being voted not as the directors recommend, but as ISS recommends.”⁸³ By creating and periodically revising its “best practices” voting guidelines—often based on input from its institutional clients—ISS fosters institutional shareholder activism and helps those clients with fiduciary obligations to vote and thus protect plan assets.⁸⁴ Without this coordinating function, institutional shareholders would bear the costs of doing their own voting research, leading to classic collective action problems and the underproduction of valuable monitoring and voting information.⁸⁵

In addition, ISS has taken on the role of serving as representative for shareholder voting interests.⁸⁶ ISS thus serves, on behalf of shareholders, as a monitor of company activities—reviewing director performance, shareholder proposals, and voting contests, and formulating advice to shareholders on how to vote—both for paying clients and others who use the publicly available ISS voting recommendations.⁸⁷

d. *Dampen Excesses in Executive Pay?*

Some advocates of say on pay predicted that a shareholder say-on-pay vote would dampen the upward spiral in executive pay. For example, activist institutional shareholders, such as AFSCME, anticipated that a shareholder say-on-pay vote might reduce alleged excesses in executive pay.⁸⁸ One well-known academic predicted that say-on-pay

⁸² This coordination function is illustrated by the say-on-pay voting during the 2011 proxy season, when all of the companies that failed to receive majority support for their say-on-pay resolutions had also received an “against” recommendation by ISS. See *infra* Part IV.A.3.

⁸³ Lynn A. Stout, *Why Should ISS Be the New Master of the Corporate Governance Universe?*, CORP. GOVERNANCE, Jan. 4, 2006, at 14–15.

⁸⁴ Paul Rose, *The Corporate Governance Industry*, 32 J. CORP. L. 887, 899–903 (2007) (describing business and operations of ISS).

⁸⁵ See ROBERT CHARLES CLARK, CORPORATE LAW 389–94 (1986) (describing shareholder voting in public corporations, which presents collective action problems similar to the “prisoner’s dilemma”).

⁸⁶ See Robin Sidel et al., *ISS Is Put in the Spotlight as H-P Claims Victory*, WALL ST. J., Mar. 20, 2002, at C20 (stating that ISS’s recommendation for the Hewlett-Packard and Compaq merger “helped bolster H-P’s position in one of the most contentious proxy battles in recent years”).

⁸⁷ Stephen J. Choi & Jill E. Fisch, *How to Fix Wall Street: A Voucher Financing Proposal for Securities Intermediaries*, 113 YALE L.J. 269, 294–98 (2003) (describing ISS’s role and influence).

⁸⁸ ARCHIE B. CARROLL & ANN K. BUCHHOLTZ, BUSINESS & SOCIETY: ETHICS AND STAKEHOLDER MANAGEMENT 812–13 (7th ed. 2008) (describing AFSCME’s decision to seek a say-on-pay vote at Home Depot).

votes would make directors “somewhat more attentive” to shareholder views and “might deter some egregious compensation arrangements.”⁸⁹

Other scholars have less glowing views. In a 2001 article critiquing the idea of say on pay (and anticipating the reform movement), Professors Brian Cheffins and Randall Thomas concluded that say on pay would probably be used by U.S. shareholders in a discerning fashion, but only to vote down pay arrangements that deviated “far from the norm.”⁹⁰ They predicted that say on pay would probably not realize some investors’ hopes of stifling the upward spiral in executive pay.⁹¹

More pessimistically, Gordon pointed to the U.K. experience with say on pay and cautioned that adopting say on pay in the United States would be a “dubious choice.”⁹² Gordon pointed out that during the first six years of say on pay in U.K. public companies, shareholders invariably approved the pay plans put to a vote, with no perceptible control of the upward spiral in U.K. executive pay.⁹³ Instead, he found that executive pay in U.K. public companies continued to rise “significantly” and the growth rate for long-term incentive plans has been higher than in the United States.⁹⁴

e. *Strengthen Pay-for-Performance Relationship?*

But even more than the debate on whether say on pay would affect overall increases in executive pay, the academic debate turned on whether a shareholder vote would create a stronger relationship between “pay and performance” and reduce the incidence of “pay for failure.”⁹⁵ In testimony before Congress, Professor Lucian Bebchuk urged that shareholders receive an advisory vote on executive pay at U.S. companies, concluding that such a vote would allow shareholders to express their views on flawed pay practices, particularly pay unconnected with company performance.⁹⁶

⁸⁹ Lucian A. Bebchuk & Holger Spamann, *Regulating Bankers' Pay*, 98 GEO. L.J. 247, 276 (2010) (commenting on possible effects of say on pay for TARP recipients).

⁹⁰ Cheffins & Thomas, *supra* note 6, at 310.

⁹¹ *Id.* at 310, 315 (explaining that empirical studies on the say-on-pay experience in the United States “do[] not provide an endorsement for major reform”).

⁹² Gordon, *supra* note 69, at 325.

⁹³ *See id.* at 341 (“[S]hareholders invariably approve the Directors Remuneration Report, with perhaps eight turndowns across thousands of votes over a six-year experience.”).

⁹⁴ *See id.*

⁹⁵ *See generally* Ferri & Maber, *supra* note 61.

⁹⁶ Bebchuk Testimony, *supra* note 63, at 68–70.

In response, some critics of say on pay questioned the premise that pay and performance are actually decoupled.⁹⁷ In testimony before the House Committee on Financial Services in 2007, Kaplan stated:

While there have clearly been abuses and unethical CEOs, pay for the typical CEO appears to be largely driven by market forces. . . . Firms with CEOs in the top decile of actual pay earned stock returns that were 90% greater than those of other firms in their industries over the previous 5 years. Firms with CEOs in the bottom decile of actual pay underperformed their industries by almost 40% in the previous 5 years. The results are qualitatively similar if we look at performance over the previous three years or previous year. There can be absolutely no doubt that the typical CEO in the U.S. is paid for performance.⁹⁸

Nonetheless, in a detailed study of the U.K. say-on-pay experience that looked at both disclosed changes in compensation contracts and estimated undisclosed changes (through a regression of CEO pay based on economic determinants), Professors Ferri and Maber summarized their conclusions:

We document a positive market reaction to the announcement of say on pay regulation for firms with controversial CEO pay practices and, more specifically, weak penalties for poor performance, consistent with shareholders perceiving say on pay as a value enhancing monitoring mechanism. We also find that firms respond to high voting dissent by removing controversial provisions criticized as rewards for failure, such as long notice periods and retesting provisions for option grants. Finally, we find a significant increase in the sensitivity of CEO pay to poor performance, particularly among firms that experience high dissent at the first vote and firms with excess CEO pay before the regulation.⁹⁹

3. *Congressional Debate over Say on Pay*

The academic debate also echoed in Congress, where say on pay was first proposed in the House of Representatives in 2006.¹⁰⁰ The

⁹⁷ Bainbridge, *supra* note 78, at 1809 (surveying literature on whether U.S. executive pay schemes decoupled executive compensation from performance and concluding that the “core premise behind say-on-pay remains, at best, unproven”).

⁹⁸ Kaplan Testimony, *supra* note 66, at 122–23 (describing his paper with Josh Rauh that looked at CEO pay from 1999 to 2004).

⁹⁹ Ferri & Maber, *supra* note 61, at 26.

¹⁰⁰ Say on pay in Congress dates back to 2005, when Rep. Barney Frank (D-MA), Chairman of the House Committee on Financial Services, introduced legislation providing shareholders with a nonbinding, advisory vote on executive compensation practices. *See* Protection Against Executive Compensation Abuse Act, H.R. 4291, 109th Cong. (2005), available at <http://www.gpo.gov/fdsys/pkg/BILLS-109hr4291ih/pdf/BILLS-109hr4291ih.pdf>. In 2007, a similar provision was part of the Shareholder Vote on Executive Compensation Act, which passed the House of Representatives, but did not advance in the Senate.

congressional debate intensified in March 2009, when the House Committee on Financial Services held hearings in the wake of reports of sizeable executive bonuses at financial firms that had received bailout funds (such as American International Group (AIG)), thus leading to the legislation that required say on pay for financial firms receiving TARP funds.¹⁰¹ The debate came to a head in June 2009, when the House Committee held hearings on expanding say on pay to all public companies, eventually approving the say-on-pay provisions incorporated into the Dodd-Frank Act.¹⁰²

The say-on-pay provisions were contentious.¹⁰³ Congressional supporters—repeating many of the points made by academic supporters—anticipated that say-on-pay: (1) would empower shareholders to vote down pay structures that encourage excessive risk taking,¹⁰⁴ (2) “would be a very significant move forward in terms of transparency and accountability,”¹⁰⁵ (3) would help arrest the upward spiral in CEO pay,¹⁰⁶ and (4) would compel corporate boards to align pay with the corporation’s financial performance.¹⁰⁷ In short, the legislative supporters of say on pay predicted that a mandatory shareholder vote

See H.R. 1257, 110th Cong. (2007) (as passed by House, April 20, 2007), available at <http://www.gpo.gov/fdsys/pkg/BILLS-110hr1257eh/pdf/BILLS-110hr1257eh.pdf>; S. 1181, 110th Cong. (2007), available at <http://www.gpo.gov/fdsys/pkg/BILLS-110s1181is/pdf/BILLS-110s1181is.pdf>.

¹⁰¹ Prompted by the bailout of AIG in September 2008, the Financial Services Committee resurrected say on pay in 2009, holding hearings in March 2009 to investigate pay practices at AIG and in the financial services industry. See *Oversight of the Federal Government’s Intervention at American International Group: Hearing Before the H. Comm. on Fin. Servs.*, 111th Cong. 5–6 (2009), available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/111-20.pdf. The hearings led to say-on-pay provisions in the American Recovery and Reinvestment Act of 2009, which built on restrictions on executive pay under the Emergency Economic Stabilization Act of 2008, and required the SEC to issue say-on-pay regulations for financial firms receiving funds under TARP.

¹⁰² The result was the Corporate and Financial Institution Compensation Fairness Act, passing the House in July 2009. H.R. 3269, 111th Cong. (2009) (as passed by House, July 31, 2009), available at <http://www.gpo.gov/fdsys/pkg/BILLS-111hr3269eh/pdf/BILLS-111hr3269eh.pdf>.

¹⁰³ Bainbridge, *supra* note 78, at 1808 (identifying support from institutional shareholders—such as the Council of Institutional Shareholders and the Investor’s Working Group—and organized labor—such as AFSCME and the AFL-CIO—with opposition from organized management groups—including the Business Roundtable and the U.S. Chamber of Commerce).

¹⁰⁴ *Compensation Structure and Systemic Risk: Hearing Before the H. Comm. on Fin. Servs.*, 111th Cong. 1–2 (2009) [hereinafter *Hearing on Compensation Structure and Systemic Risk*] (statement of Rep. Barney Frank, Chairman, H. Comm. on Fin. Servs.); *id.* at 5 (statement of Rep. David Scott) (arguing that executive pay systems have “no downside” for an executive’s failure).

¹⁰⁵ *Id.* at 13 (statement of Gene Sperling, Counselor to the Sec’y of the Treasury, U.S. Dep’t of Treasury).

¹⁰⁶ See H.R. REP. NO. 110-88, at 3 (2007) (noting that median CEO pay had grown to \$13.5 million during the 2005 fiscal year at the 1,400 largest U.S. public companies).

¹⁰⁷ *Hearing on Compensation Structure and Systemic Risk*, *supra* note 104, at 4–5 (statement of Rep. David Scott).

would alter the balance of power in U.S. public corporations, especially regarding executive pay, and thus move it decidedly toward shareholders. As Gene Sperling from the Treasury Department explained:

You are empowering shareholders with the ability to have stronger oversight. You are forcing the company to think more seriously about what they do, how it will be perceived and not just to go on automatic pilot doing practices that are not defensible simply because of their peer group is doing it.¹⁰⁸

Opponents argued that say on pay would cause government to intrude in the boardroom,¹⁰⁹ put executive compensation in the “hands of government bureaucrats,”¹¹⁰ and upset the traditional distribution of power between boards and shareholders.¹¹¹ They argued that say on pay would make it harder for companies, particularly those in financial sector, to hire and retain “the best and the brightest”¹¹² and that smaller companies would find reporting their pay plans and giving shareholders a vote to be prohibitively expensive.¹¹³ Opponents also argued that say on pay would lead to activist shareholders favoring a narrow range of compensation programs, pushing U.S. public companies to adopt “one-size-fits-all” compensation plans.¹¹⁴ In short, the legislative supporters predicted mandatory say on pay would impose costs exceeding any benefits.

The debate in Congress thus mirrored—and in some cases went beyond—the academic debate. Congressional supporters anticipated a change for the better in the balance of power between shareholders and managers, as improved shareholder oversight would limit excessive risk taking, reduce the CEO-pay spiral, and link pay to performance. Congressional opponents anticipated a change for the worse in the balance of power, as shareholders would limit the board’s compensation flexibility, impose unnecessary costs on small business, and make executive hiring more difficult.

¹⁰⁸ *Id.* at 38 (statement of Gene Sperling, Counselor to the Sec’y of the Treasury, U.S. Dep’t of Treasury).

¹⁰⁹ *Id.* at 3–4 (statement of Rep. Spencer Bachus).

¹¹⁰ *Id.* at 9 (statement of Rep. Scott Garrett); *id.* at 3 (statement of Rep. Spencer Bachus) (arguing that the government should not mandate private compensation policies).

¹¹¹ *Id.* at 5 (statement of Rep. Michael Castle) (pointing out that stockholders have the right to change directors); *id.* at 7 (statement of Rep. Jeb Hensarling) (arguing that executive pay is probably a “nonexistent problem,” but shareholders should vote for new management).

¹¹² *Id.* at 7 (statement of Rep. Judy Biggert).

¹¹³ *Id.* at 32 (statements of Rep. Scott Garrett and Scott G. Alvarez, Gen. Counsel, Bd. of Governors of the Fed. Reserve Sys.) (suggesting larger firms could more easily bear costs of say-on-pay votes than smaller firms, which “do a better job of aligning risk and rewards”).

¹¹⁴ Bainbridge, *supra* note 78, at 1810.

III
PRE-DODD-FRANK: SHAREHOLDER VOTING ON EXECUTIVE
PAY

In this Part, we analyze the pre-Dodd-Frank data on shareholder and management proposals on executive pay issues. This includes proposals submitted by shareholders using Rule 14a-8, which touch on a broad range of pay practices including say on pay, as well as recent management-sponsored say-on-pay proposals. Our data set includes all such proposals from 2003 to 2010.¹¹⁵ At present, we are unable to analyze data from the most recent year that covers the introduction of mandatory say-on-pay votes because the data was not yet available at the time we wrote this Article.

A. Proposal Frequency and Shareholder Support

1. *Mixed Support for Shareholder-Sponsored Proposals on Executive Pay (Other Than Say on Pay)*

We begin by using voting data for 2003–2010¹¹⁶ to examine pre-Dodd-Frank shareholder voting patterns “for” and “against” shareholder-sponsored resolutions on executive pay under Rule 14a-8.¹¹⁷ In Table 1, we divide these shareholder proposals into seven categories:

- (1) reports on executive pay,
- (2) increased disclosure of executive pay,
- (3) shareholder approval of executive pay (excluding say-on-pay proposals),
- (4) caps on executive pay,
- (5) links of executive pay to corporate performance,
- (6) reductions of executive pay, and
- (7) restrictions and limitations on executive pay.

¹¹⁵ The data were supplied by ISS Corporate Governance Services, a subsidiary of MSCI Inc. See *About ISS*, ISS, <http://www.issgovernance.com/about> (last visited Mar. 19, 2012). We note that the annual data run from July to June of the following year. In other words, the 2003 data are collected from July 2003 to June 2004.

¹¹⁶ Each year corresponds to one proxy season. For example, 2010 data is collected for the time period from July 1, 2009 to June 30, 2010 so that it covers the 2010 proxy season (which runs from January to June 2010).

¹¹⁷ Most shares of U.S. public companies are held by institutional investors. MATTEO TONELLO & STEPHAN RABIMOV, THE CONFERENCE Bd., THE 2010 INSTITUTIONAL INVESTMENT REPORT: TRENDS IN ASSET ALLOCATION AND PORTFOLIO COMPOSITION 27 tbl.13 (2010).

TABLE 1: SHAREHOLDER PROPOSALS ON EXECUTIVE PAY
(NUMBER AND PERCENT SUPPORT)

	2003	2004	2005	2006	2007	2008	2009	2010	Majority Support
Report	16 (11.2%)	5 (10.3%)	25 (8.4%)	3 (9.0%)	4 (6.9%)	3 (7.6%)	3 (10.2%)	9 (6.2%)	0
Disclose			1 (5.5%)	9 (27.4%)	3 (8.0%)	4 (8.3%)	3 (10.8%)	2 (10.2%)	0
Approve	16 (56.6%)	23 (48.9%)	14 (55.4%)	15 (41.4%)	7 (45.8%)	3 (57.3%)	5 (31.9%)	4 (58.3%)	43
Cap		1 (5.1%)	9 (10.2%)	6 (10.7%)	8 (5.2%)	7 (5.4%)	1 (9.2%)	2 (5.1%)	0
Link	48 (16.6%)	7 (34.6%)	35 (29.6%)	37 (32.5%)	73 (29.8%)	27 (32.3%)	8 (26.0%)	12 (32.5%)	14
Reduce	47 (32.6%)	33 (13.2%)	7 (12.0%)	11 (23.2%)	16 (23.0%)	15 (20.2%)	6 (23.9%)	10 (29.1%)	14
Restrict				3 (30.1%)	7 (23.1%)		25 (29.1%)	38 (25.8%)	0

We employ the same coding system as Thomas and Martin¹¹⁸ and explain the different categories more fully in the footnote below.¹¹⁹

Table 1 shows a wide variation in the number and support levels for the different categories of shareholder proposals that relate to executive pay.¹²⁰ Over the eight-year period shown, it is apparent that shareholder-sponsored 14a-8 proposals—asking boards to compile reports on executive pay, to make additional disclosures about executive pay, or that try to get boards to cap executive pay levels—were relatively few in number and attracted low levels of average voting support (often less than 10% of votes cast).¹²¹ None of these proposals received majority support from shareholders.

With respect to “report proposals” and “disclose proposals” calling for reports and additional disclosures on executive pay, we think that there is a straightforward explanation for the lack of shareholder

¹¹⁸ For further discussion of this methodology, see Thomas & Martin, *supra* note 22, at 1073.

¹¹⁹ We define each category as follows:

- Report: Seeks a committee report that reviews executive compensation practices (such as pay disparities);
- Disclose: Seeks additional information about compensation levels (such as employees whose base salary exceeds \$100,000);
- Approve: Seeks shareholder approval of certain pay practices (other than say on pay) such as retirement plans or severance payments);
- Cap: Requests board to limit executive pay (such as dollar caps or limits in shareholder-approved plan);
- Link: Requests board to tie executive pay to performance (such as pay linked to total shareholder returns);
- Reduce: Seeks discontinuance of certain pay practices (such as stock options, tax gross-ups, clawbacks);
- Restrict: Seeks to limit total pay of top executives (such as, no bonuses, no golden parachutes, impose stock holding period).

¹²⁰ See *supra* Table 1.

¹²¹ *Id.*

support: shareholders already receive voluminous disclosures about the levels and composition of pay for the top five executives at public companies and so they do not see the need for more information or reports from the company. The tepid shareholder support for pay caps are more interesting, though they suggest that shareholders are not too concerned about overall pay levels. These data are consistent with the claim that shareholders did not view overall pay levels as a real problem during the 2003–2010 time period, or alternatively, that if shareholders believed pay levels were a problem, they did not think that boards were likely to lower them voluntarily.

A second set of proposals—relating to linking, reducing, and restricting executive pay—were more numerous and received stronger levels of shareholder support, ranging from approximately 15% to 30% of votes cast.¹²² Link proposals generally ask boards to tie executive pay levels to firm performance measures, such as total shareholder returns. Some of these proposals attracted majority support. While shareholders generally seemed to agree on the importance of pay for performance, we note that almost all U.S. companies already have some portion of their executives' pay in the form of pay for performance, most commonly stock options or restricted stock.¹²³ These proposals were seeking to alter existing payments in particular ways, such as adding performance hurdles or changing the performance metric. Given the widespread divergence of opinions about the appropriate form for pay for performance,¹²⁴ it is not surprising that shareholders might hold views different from management on the appropriate pay-for-performance method. This could explain both the level of interest in the topic (the number of proposals) as well as the greater shareholder support for proposals seeking to have boards make such changes.

“Reduce proposals” typically ask the board to discontinue using certain types of executive pay mechanisms, such as golden parachutes, tax gross-ups, and others. These proposals have become much less numerous in recent years, although they have continued to attract reasonable levels of shareholder support and, in the 2003–2010 period, fourteen of them obtained majority support.¹²⁵ Taking the example of golden parachutes and tax gross-ups on change-of-control severance payments, we begin by noting that these agreements are quite common at U.S. public companies.¹²⁶ There has been a wide

¹²² *Id.*

¹²³ See Core, Guay & Thomas, *supra* note 3, at 1172 (explaining that “pay for performance is provided primarily through executive stock and option holdings”).

¹²⁴ See *id.* at 1177–79 (discussing some of these differences).

¹²⁵ See *supra* Table 1.

¹²⁶ Stewart J. Schwab & Randall S. Thomas, *An Empirical Analysis of CEO Employment Contracts: What Do Top Executives Bargain For?*, 63 WASH. & LEE L. REV. 231, 263 (2006).

spectrum of views about whether golden parachutes and tax gross-ups constitute value-maximizing corporate agreements or are just director-sponsored giveaways to top executives.¹²⁷ The decline of the hostile takeover over the past decade has likely reduced the salience of these payments for many investors, perhaps explaining the decline in the number of such proposals. As with “link proposals,” we believe it likely that shareholders have been of two minds about reduce proposals that seek to eliminate these pay arrangements, and in the end prefer to let the board of directors determine for itself whether to do so.

“Restrict proposals” have become much more popular in the last few years and during the 2003–2010 period attracted 25% to 30% support on average.¹²⁸ They seek to restrict certain pay practices, such as imposing holding periods on restricted stock payments. Given the overall shift toward the use of restricted stock in lieu of stock options that has occurred over the past several years,¹²⁹ it makes sense that shareholder attention would focus on the length of the holding period for these shares. There is, however, no consensus on what constitutes the optimal holding period for restricted stock, and reasonable shareholders could differ on the question.¹³⁰ Hence, this determination is likely to depend on the particular circumstances of each individual corporation and its executives—a notion which, in the eyes of some shareholders, will make the board of directors the best-informed decision makers on the question. This may explain the moderate support levels that we observe in the data.

“Approve proposals,” the last group of shareholder proposals shown in Table 1, request the board to submit certain pay practices for shareholder approval, including the use of Supplemental Employee Retirement Plans (SERPs), as well as other retirement plans or severance payments (they do not include say-on-pay votes, which we analyze separately in Table 2 below). What is striking about approve proposals is the relatively high levels of shareholder support they re-

¹²⁷ Compare Judith C. Machlin, Hyuk Choe & James A. Miles, *The Effects of Golden Parachutes on Takeover Activity*, 36 J.L. & ECON. 861, 875 (1993) (finding that golden parachutes increase the likelihood of a takeover but not the premium paid, and that they do not appear to incentivize managers to accept lowball bids), with Lucian Arye Bebchuk, Jesse M. Fried & David I. Walker, *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 836 (2002) (“[T]he practice of making [gratuitous] payments [to managers] is an indication that managers use their power to extract rents.”).

¹²⁸ See *supra* Table 1.

¹²⁹ Kevin J. Murphy, *The Politics of Pay: A Legislative History of Executive Compensation*, in RESEARCH HANDBOOK ON EXECUTIVE PAY, *supra* note 1 (manuscript at 46).

¹³⁰ See Core, Guay & Thomas, *supra* note 3, at 1179–81 (explaining that although shareholders may view a CEO who exercises options or sells his stock as unwinding his incentives, it is sometimes optimal for a CEO to sell equity).

ceived in the pre-Dodd-Frank period, including majority support for 43 of them.¹³¹

Approve proposals are an important category from our perspective as they are the closest in nature to the say-on-pay proposals mandated by Dodd-Frank. There are some important differences though. First, these proposals were only made at a small subset of public companies, presumably ones where activist shareholders believed that they had an especially strong case for seeking shareholder support. Second, they targeted specific, less popular payment practices, such as SERPs, rather than the publicly disclosed overall pay packages of top executives. Third, they are made by self-selected shareholders, rather than management, and some investors may be skeptical of the motivations of the individual or group making the proposals.¹³² For all of these reasons, we would not expect that the success (or failure) of these proposals would translate directly into a similar fate for management-sponsored say-on-pay proposals.

With all of those qualifications, the difference in the level of shareholder support for this category of proposals is striking. It is apparent that shareholders hold, at least for the subset of firms where the proposals were submitted, a strong, although generally minority view that boards should give shareholders more input into pay practices.

2. *Strong Support for Shareholder-Sponsored Say-on-Pay Proposals*

Table 2 shows the pre-Dodd-Frank experience of say-on-pay shareholder-sponsored proposals using Rule 14a-8 (Panel A) and management-sponsored proposals (Panel B).¹³³ Panel A shows that shareholders started making these proposals in 2006 and that the number of them increased steadily until 2010 when there was a slight decline, perhaps in anticipation of the effect of Dodd-Frank's mandate or perhaps because of the increased number of management-sponsored say-on-pay proposals that were either voluntary or those required by receipt of TARP funds. Panel B shows that management-sponsored proposals seeking advisory shareholder approval of executive pay began to show up a bit later and did not really take off until 2009 when TARP firms were required to do so.

It is important to note that the shareholder support column has a different interpretation for the shareholder-sponsored proposals and the management-sponsored proposals. For shareholder-sponsored

¹³¹ See *supra* Table 1.

¹³² This may be particularly true for certain gadfly investors or labor groups that are involved in disputes with the targeted firms. For a discussion of the issues arising out of labor shareholder activism, see Schwab & Thomas, *supra* note 76.

¹³³ See *infra* Table 2.

proposals, the percentage of votes cast in favor of the proposal are votes asking management to permit shareholders to approve executive pay for the five named individual executives. A support level below 50% therefore should be interpreted as meaning that less than a majority of the total votes cast are in favor of such an advisory vote. By comparison, a management-sponsored proposal receiving majority support indicates that a majority of the votes cast approved of the particular pay packages in consideration.

TABLE 2: SAY-ON-PAY PROPOSALS PRE-DODD-FRANK
(NUMBER, SUPPORT, AND MAJORITY SUPPORT)

Panel A—Shareholder-Sponsored Proposals

Year	Number of Say-on-Pay 14a-8 Proposals	Shareholder Support (% "For")	Number Receiving Majority Support
2006	5	42.5%	0
2007	52	37.5%***	7
2008	71	38.1%***	8
2009	61	41.1%***	21
2010	48	40.3%***	9

*** Represents a test of the difference of the mean of the percentage of shares voted in favor of say-on-pay vote by year between shareholder and management proposals at the 1% level in a two-tailed test.

Panel B—Management-Sponsored Proposals

Year	Number of Say-on-Pay Proposals	Shareholder Support (% "For")	Number Receiving Majority Support
2006	0	0	0
2007	2	98.2%***	2
2008	8	89.2%***	8
2009	152	87.6%***	152
2010	146	88.7%***	143

*** Represents a test of the difference of the mean of the percentage of shares voted in favor of say-on-pay vote by year between shareholder and management proposals at the 1% level in a two-tailed test.

Turning to the results, we see that shareholder-sponsored proposals attract significant support, even majority support in some cases. Since shareholder activists select the companies at which they submit executive pay proposals, and have in the past targeted companies with either relatively poor performance,¹³⁴ "excess" executive pay,¹³⁵ or both, we would expect that these proposals would attract relatively high levels of shareholder support—and they do. Overall voting support levels have consistently hovered around 40% over the entire time period, with a sharp spike in the number of proposals receiving major-

¹³⁴ Thomas & Martin, *supra* note 22, at 1021.

¹³⁵ Ertimur, Ferri & Muslu, *supra* note 23, at 34.

ity approval in 2009, prior to the enactment of Dodd-Frank.¹³⁶ As we will see in Table 3, both of these are quite similar with those for shareholder-sponsored approve proposals.

Management-sponsored proposals asking for advisory shareholder approval of top executive pay packages appear to be very different. Overall shareholder support for these proposals is extremely high—around 90% for 2008, 2009, and 2010—and only a small handful—three in 2010—did not receive majority support by shareholders.¹³⁷ The differences between the management and shareholder proposal support levels are statistically significant at the 1% level using year-by-year comparisons.

There is the possibility that self-selection effects are present for the management-sponsored proposals because, other than financial institutions that were required to put these proposals on their ballot, management voluntarily added these proposals to the ballot. While there may be a host of motivations for doing so, companies that have good investor relations and that do not anticipate significant investor dissent over pay practices might be more likely to make such proposals. An alternative explanation is that these are mostly firms with “bad” compensation practices that were getting shareholder pressure to put them on the ballot. In either event, it is striking how little shareholder discontent these vote totals reflect.

In Table 3, we aggregate all of the data contained in Tables 1 and 2 to present a broader overall picture of pre-Dodd-Frank shareholder voting outcomes.¹³⁸ Looking first at the average voting percentages, management-sponsored say-on-pay proposals attract the highest levels of support by far—more than twice as high as any of the shareholder-sponsored proposals.¹³⁹ Amongst the shareholder-sponsored proposals, approve proposals and say-on-pay proposals—both of which request a shareholder vote on executive pay matters—are the two categories that receive the highest shareholder support by a wide margin.¹⁴⁰

Looking at which proposals are most likely to attract majority shareholder support, management-sponsored say-on-pay proposals receive by far the greatest percentage support.¹⁴¹ Of the shareholder-sponsored proposals, approve proposals receive the highest support, followed by shareholder-sponsored say-on-pay proposals, with reduce proposals and link proposals in the single-digit percentages. Based on

¹³⁶ See *supra* Table 2.

¹³⁷ *Id.*

¹³⁸ See *infra* Table 3.

¹³⁹ *Id.*

¹⁴⁰ *Id.*

¹⁴¹ The differences between shareholder support levels for shareholder-sponsored and management-sponsored say-on-pay levels are significant at the 1% level.

this evidence, we would project that management-sponsored say on pay after Dodd-Frank would be likely to attract high levels of shareholder support and that only a relatively small fraction of such proposals would likely fail to attract majority support.

TABLE 3: PRE-DODD-FRANK EXECUTIVE PAY PROPOSALS

Type of proposal	Number of Proposals	Percentage "For" Vote	Majority Support
Shareholder-Sponsored			
Report	68	8.9%	0.0%
Disclose	22	16.5%	0.0%
Approve	87	49.6%	49.43%
Cap	34	7.6%	0.0%
Link	247	28.0%	5.7%
Reduce	145	23.5%	9.7%
Restrict	73	26.8%	0.0%
Say on Pay	282	42.0%***	16.0%
Management-Sponsored			
Say on Pay	308	88.2%***	99.0%

*** Represents a test of the difference of the mean of the percentage of shares voted in favor of say-on-pay vote between shareholder- and management-sponsored proposals at the 1% level in a two-tailed test.

B. Effect of ISS Voting Recommendations

Having looked at the overall voting trends on shareholder executive pay proposals, we turn next to measuring how shareholder voting correlates with management and ISS recommendations. Table 4 breaks out the differential effects of ISS and management voting recommendations.¹⁴² Several interesting patterns appear from the data. First, management rarely recommends that shareholders vote for a shareholder proposal related to executive pay: only five times out of a total of 1,240 shareholder proposals (0.40%) made from 2003 to 2010 on the topic.¹⁴³ In four of the five instances, these proposals garnered majority support, while in the fifth case ISS recommended against the proposal.¹⁴⁴

Second, for management-sponsored say-on-pay proposals, ISS recommended in favor of the proposal in 234 of the 303 cases, or 77.2% of the time.¹⁴⁵ These proposals obtained 92.4% voting support from shareholders. However, in the remaining 69 cases where ISS recommended shareholders vote against a company's executive pay arrangements, shareholder voting support dropped to 73.4%, or an average decrease of 19.0% of the votes cast. Thus, withdrawal of ISS support

¹⁴² See *infra* Table 4.

¹⁴³ *Id.*

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

for a management-sponsored proposal was associated with some, but not a decisive, drop in shareholder voting support.

Turning to shareholder-sponsored proposals, ISS generally recommended against proposals in the report, disclose, cap and reduce categories. For approve, link, restrict and shareholder-sponsored say-on-pay proposals, ISS overwhelmingly recommended “for” votes. In all of the shareholder-sponsored proposal categories, a negative ISS recommendation was associated with a lower shareholder support percentage. The effect is close to or above 20% of total voting percentages for the six categories: disclose, approve, link, reduce, restrict and shareholder-sponsored say on pay.

Collectively, these data suggest that in the pre–Dodd-Frank period, ISS “for” voting recommendations on most categories of advisory executive pay proposals were associated with about a 20% impact on shareholder support for the proposal. This seems to be consistently true for management-sponsored say-on-pay proposals as well as most categories of shareholder-sponsored proposals. However, as we show next, these results may overstate the effect of an ISS voting recommendation on shareholder voting.

TABLE 4: PRE–DODD-FRANK MANAGEMENT AND ISS RECOMMENDATIONS
(NUMBER AND PERCENT SUPPORT)

	ISS and Management “For” Recommendation	Management Only “For” Recommendation	ISS Only “For” Recommendation	ISS and Management “Against” Recommendation
Shareholder-Sponsored Proposals				
Report	0	1 (24.5%)	1 (15.5%)	66 (8.6%)
Disclose	0	0	5 (41.7%)	17 (9.0%)
Approve	2 (84.4%)	0	79 (50.3%)	6 (28.2%)
Cap	0	0	1 (24.7%)	33 (7.1%)
Link	1 (91.3%)	0	156 (35.5%)	89 (14.1%)
Reduce	0	0	53 (43.1%)	88 (10.4%)
Restrict	0	0	70 (27.6%)	3 (8.3%)
Say on Pay	1 (51.8%)	0	273 (42.0%)	2 (12.7%)
Management-Sponsored Proposals				
Say on Pay	234 (92.4%)	69 (73.4%)	0	0

To get a deeper insight into how shareholder voting correlates with management and ISS recommendations, we applied a methodol-

ogy that we developed in an earlier article.¹⁴⁶ This technique allowed us to isolate ISS voting recommendations from management recommendations and thereby calculate an upper limit on the correlation of shareholder voting with ISS voting recommendations. We summarize this procedure briefly below.¹⁴⁷

To identify the extent to which shareholder voting has been influenced by ISS, we first compiled a matrix for different categories of proposals, showing management and ISS recommendations on various proposals and how shareholders had voted on those proposals. The two-by-three matrix, which we created by matching for-or-against recommendations by ISS with for-or-against recommendations by management, showed for each cell the number of proposals presented for shareholder vote and the percentage of favorable shareholder votes on the proposals.¹⁴⁸

FIGURE 1: PROPOSAL MATRIX

<u>Proposal Category</u>		<u>Management</u>		
		For	Against	Other
ISS	For	(A)	(B)	
	Against	(C)	(D)	

Looking at the matrix, we then sought to identify the extent to which shareholder voting was consistent with management and ISS recommendations. We focused on cells, (A)–(D), where management and ISS had actually given recommendations on proposals (either for or against), and disregarded the relatively few cases where management made some other statement about the proposal. We were unable to test for “causation”—that is, whether recommendations actually influenced voting behavior or simply anticipated existing voting preferences.

In evaluating these results, it is not enough to simply notice, for example, that in cell (A) shareholder voting tended to be favorable when both management and ISS were for the proposals, since any unfavorable votes in cell (A) indicated shareholders were voting contrary to both management and ISS recommendations. To capture the extent to which shareholders were voting consistently with management and ISS recommendations, we looked at all the permutations to iden-

¹⁴⁶ See generally James Cotter, Alan Palmiter & Randall Thomas, *ISS Recommendations and Mutual Fund Voting on Proxy Proposals*, 55 VILL. L. REV. 1 (2010) (analyzing mutual fund voting data from 2003 to 2008).

¹⁴⁷ For greater detail on our methodology, see *id.* at 46–52.

¹⁴⁸ See *id.* at 46.

tify the proportion of shareholder voting decisions that were consistent or inconsistent with management and ISS recommendations, breaking down shareholder voting into four categories:

- (1) Voting that was consistent with *both* management and ISS recommendations—"for" votes in cell (A) and "against" votes in cell (D);
- (2) Voting that was consistent with *only management*, but not ISS, recommendations—"against" votes in cell (B) and "for" votes in cell (C);
- (3) Voting that was consistent with *only ISS*, but not management, recommendations—"for" votes in cell (B) and "against" votes in cell (C); and
- (4) Voting that was consistent with *neither* ISS nor management recommendations—"against" votes in cell (A) and "for" votes in cell (D).

In this way, we identified how often shareholders voted consistently with joint recommendations by management and ISS, management-only recommendations, ISS-only recommendations, and the shareholder's own determination. The first row reports the results for all management say-on-pay proposals, while the second row reports them for shareholder say-on-pay proposals.¹⁴⁹

TABLE 5: EFFECT OF MANAGEMENT AND ISS RECOMMENDATIONS ON VOTING ON SAY-ON-PAY PROPOSALS

Type of Say-on-Pay Proposal	Both	Mgmt. Only	ISS Only	Neither	Total
Management-Sponsored	71.4%	16.7%	6.1%	5.9%	100.0%
Shareholder-Sponsored	0.8%	57.3%	41.6%	0.3%	100.0%

For management-sponsored say-on-pay proposals, what is striking is that shareholders are more than twice as likely to follow management's recommendation than they are ISS's recommendation when the two recommendations differ. In fact, for management-sponsored proposals, shareholders are almost as likely to vote following their own counsel (5.9%) as they are to follow ISS when ISS's recommendation differs from management's recommendation (6.1%). Both of these results make clear that for management-sponsored proposals, ISS has less impact than might seem to be the case from the raw data presented in Table 4.

With shareholder-sponsored say-on-pay proposals, however, the ISS effect is much stronger. Remembering that management almost

¹⁴⁹ The reader is reminded that shareholder-submitted say-on-pay proposals ask the board of directors to permit shareholders to hold advisory votes, whereas management-submitted say-on-pay proposals are the votes on whether or not to approve the pay package.

never issues a “for” recommendation on these proposals, virtually all shareholder support for these proposals are in accordance with a positive ISS voting recommendation.

IV

POST-DODD-FRANK: FIRST YEAR OF SAY ON PAY

Although we are currently unable to analyze the results of the first year of say-on-pay votes under Dodd-Frank because of delays in getting the data, it is apparent from academic and practitioner commentary that the say-on-pay mandate produced a mixed set of results. Many of the concerns skeptics had expressed about say on pay did not materialize. For example, shareholders proved not to be indifferent about say on pay and did not blindly follow ISS recommendations.¹⁵⁰ Likewise, some supporters did not realize their hopes. For example, failed say-on-pay votes were rare, and while some companies made adjustments to their pay programs, there was no rush to undertake broad changes in executive pay practices.¹⁵¹

A. Shareholder Voting on Say-on-Pay Proposals

In the 2011 proxy season, the inaugural year for the Dodd-Frank say-on-pay mandate, shareholders voted on say-on-pay proposals submitted by management at about 2,200 U.S. public companies.¹⁵² A brief summary of the highlights of these votes from a report prepared by ISS shows that:

- Shareholders showed strong support for existing pay practices, with say-on-pay votes garnering on average 91.2% support.¹⁵³
- Say-on-pay proposals were voted down only 1.6% of the time (at 37 of the Russell 3000 companies subject to say-on-pay

¹⁵⁰ See Robin Ferracone, *Say on Pay in 2011, and What to Expect for 2012*, HARV. BUS. REV. BLOG NETWORK (Oct. 3, 2011, 9:30 AM), http://blogs.hbr.org/cs/2011/10/what_was_be_hind_those_say_on_p.html (concluding that investors used ISS recommendations only as guidance).

¹⁵¹ See Cheffins & Thomas, *supra* note 6, at 289; see also *Say On Pay Makes Its Debut in the 2011 Proxy Season*, COOLEY LLP (July 28, 2011), <http://www.cooley.com/65339> (noting that “the anticipated widespread stockholder challenge to perceived out-of-line pay packages did not materialize” and that out of 2,500 companies that have disclosed results, “less than 2% have reported failed say-on-pay votes”).

¹⁵² Compare TED ALLEN ET AL., INSTITUTIONAL S’HOLDER SERVS., PRELIMINARY 2011 U.S. POSTSEASON REPORT 2 (2011) [hereinafter ISS PRELIMINARY REPORT], with *An Analysis of Voting Results and Performance at Russell 3000 Companies*, EQUILAR (2011), <http://www.equilar.com/knowledge-network/research-articles/2011/pdf/Equilar-Voting-Analytics-July-2011.pdf> (counting 2,252 say-on-pay proposals from the Russell 3000 as of June 30, 2011).

¹⁵³ See ISS PRELIMINARY REPORT, *supra* note 152, at 1.

votes),¹⁵⁴ apparently mostly based on pay-for-performance concerns.¹⁵⁵

- Overall, say-on-pay votes were highly correlated to company share returns and CEO pay, with low returns and high CEO pay resulting in lower say-on-pay support.¹⁵⁶
- Companies with “layered” disclosure of their pay practices—that is, executive summaries of their pay practices, along with regular disclosure—received more say-on-pay support.¹⁵⁷
- Negative say-on-pay recommendations by ISS prompted many companies to modify their disclosure filings or to change their pay practices (sometimes retroactively) to win support.¹⁵⁸

In addition, shareholders showed a clear preference for companies holding an annual say-on-pay vote, with shareholders at 1,792 companies supporting (by majority or plurality vote) annual votes, compared to a preference of triennial voting at only 412 companies.¹⁵⁹ Despite management recommendations for triennial voting at 978 companies, a majority of shareholders voted in favor of annual voting at 564 of these companies.¹⁶⁰ In other words, say on pay promises to be an annual event at most larger public companies. We explore these findings more below.

1. *Strong Shareholder Support for Say-on-Pay Proposals*

During the 2011 proxy season (between January 21 and June 30, 2011), shareholder support for management-sponsored say-on-pay resolutions averaged 91.2% for all companies holding such a vote.¹⁶¹

¹⁵⁴ The Russell 3000 is an index that represents the 3,000 largest U.S. public companies by market capitalization, which comprise 98% of the U.S. public equity market. *Russell 3000 Index*, RUSSELL, http://www.russell.com/indexes/data/fact_sheets/us/russell_3000_index.asp (last updated Mar. 31, 2012).

¹⁵⁵ See ISS PRELIMINARY REPORT, *supra* note 152, at 1.

¹⁵⁶ *Id.* at 3.

¹⁵⁷ *Id.* at 2.

¹⁵⁸ *Id.* at 1.

¹⁵⁹ *Id.* at 4. The same pattern was observed at the first 100 filers among the Fortune 500, where shareholders at 92 of the companies gave majority support for annual say-on-pay votes—even though management had recommended annual voting at only 61 of these companies. Russell Miller & Yonat Assayag, *SOP Drives Compensation Program Changes to Enhance Pay/Performance Link*, DIRECTOR NOTES (Conference Bd.), Sept. 2011, at 6, http://clearbridgecomp.com/wp-content/uploads/TCB_DN-V3N18-11.pdf. Of the remaining eight companies—where shareholders mostly supported triennial votes—four of the companies are family controlled. *Id.*

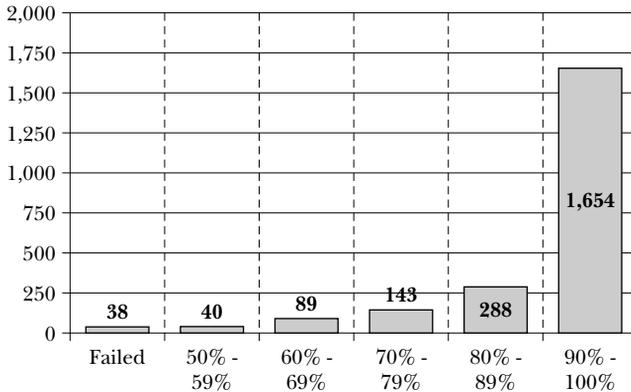
¹⁶⁰ ISS PRELIMINARY REPORT, *supra* note 152, at 4. Management recommendations for biennial voting fared even worse, with shareholders supporting annual voting at 43 of the 59 companies where management had recommended biennial voting. *Id.*

¹⁶¹ *Id.* at 2; see also Miller & Assayag, *supra* note 159, at 3 (reporting that 2,704 companies had held say-on-pay votes as of September 3, 2011).

This was almost identical to average support for TARP-funded firms in the 2010 proxy season.¹⁶²

Overall, most companies received strong support for their say-on-pay votes, with 71% of companies receiving over 90% shareholder support, 23% receiving 70–90% support, and 6% receiving 50–70% support. The following table from Equilar illustrates the strong shareholder say-on-pay support:¹⁶³

FIGURE 2: DISTRIBUTION OF COMPANIES ACCORDING TO THEIR SAY-ON-PAY APPROVAL RATES



The Conference Board identified similar results. As of July 2011, they found that failed say-on-pay votes occurred at only 36—or 1.6%—of the 2,225 Russell 3000 companies holding a say-on-pay vote in 2011.¹⁶⁴ This percentage was similar to, though a bit higher than, the percentage of failed votes in 2010 among companies that held voluntary or TARP-mandated say-on-pay votes.¹⁶⁵ As our data show, in 2010, failed votes occurred at only three companies—or 2.0%—of the 146 companies holding a say-on-pay vote.

Despite the strong support shareholders gave to most companies' executive pay packages, there have been questions whether shareholders were adequately attentive to pay levels and design. The Council of

¹⁶² See Michael Littenberg, Farzad Damania & Justin Neidig, *A Closer Look at Negative Say-on-Pay Votes During the 2011 Proxy Season*, DIRECTOR NOTES (Conference Bd.), July 2011, at 2, <http://www.szr.com/A-Closer-Look-at-Negative-Say-on-Pay-Votes-During-the-2011-Proxy-Season-07-26-2011/> (follow "View PDF" hyperlink). The Conference Board report was adapted from a study by Schulte, Roth & Zabel LLP. Noam Noked, *The Votes are In—Deconstructing the 2011 Say on Pay Vote*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (July 29, 2011, 9:09 AM), <http://blogs.law.harvard.edu/corpgov/2011/07/29/the-votes-are-in-%E2%80%94deconstructing-the-2011-say-on-pay-vote/> (posting of material prepared by Michael R. Littenberg, partner at Schulte Roth & Zabel LLP).

¹⁶³ See ISS PRELIMINARY REPORT, *supra* note 152, at 1.

¹⁶⁴ Littenberg, Damania & Neidig, *supra* note 162.

¹⁶⁵ *Id.*

Institutional Investors interviewed shareholders that had voted against say-on-pay proposals, and learned that some shareholders felt that investors generally were “still blindly following board/management recommendations,” were “too soft [in evaluating pay programs],” and were too often swayed in their votes by “who the companies’ investors are, not necessarily the quality of their program.”¹⁶⁶

2. *Negative Votes Related to Pay-for-Performance Concerns*

Thirty-seven companies failed to receive majority support for their executive pay packages.¹⁶⁷ Smaller companies were as likely as larger companies to receive an unfavorable say-on-pay vote—with 8 of the 37 companies on the S&P 500 (representing 1.6% of such larger companies) and 29 outside the S&P 500 (representing 1.6% of such smaller companies).¹⁶⁸

In looking at the failed votes, both ISS and the Conference Board identified pay-for-performance issues as the principal reason for the negative shareholder vote.¹⁶⁹ For example, about half of the companies with failed say-on-pay votes had reported negative double-digit three-year total share returns.¹⁷⁰ Other pay issues—such as tax gross-ups, discretionary bonuses, inappropriate peer benchmarking, and unpopular pay committee members—were also mentioned.¹⁷¹

In fact, for nearly every company where say on pay failed to get majority support, there was a company-specific story of shareholder discontent, particularly involving the disconnect between pay and performance at the company:

¹⁶⁶ Robin Ferracone & Dayna Harris, *Say on Pay: Identifying Investor Concerns*, COUNCIL OF INSTITUTIONAL INVESTORS 16 (Sept. 2011) (alteration in original) (internal quotation marks omitted), <http://www.cii.org/UserFiles/file/resource%20center/publications/Say%20On%20Pay%20-%20Identifying%20Investor%20Concerns.pdf>.

¹⁶⁷ *Id.* at 2. Two of the companies (Cutera and Dex One) have since left the Russell 3000 index. In addition, two companies (Cooper Industries and Doral Financial) failed to get majority support for their say-on-pay proposals if abstentions are included, though these were not included in the lists compiled by the ISS and the Conference Board. See ISS PRELIMINARY REPORT, *supra* note 152, at 2–3.

¹⁶⁸ See ISS PRELIMINARY REPORT, *supra* note 152, at 3. Nor did failed say-on-pay votes track market capitalization, with failed votes proportional to the number of companies in different market capitalization ranges. Littenberg, Damania & Neidig, *supra* note 162, at 3 (finding that 17 failed votes occurred at companies with less than \$1 billion in market cap, 11 at companies with \$1–\$5 billion in market cap, and eight at companies with greater than \$5 billion in market cap—correlating with the number of companies in each segment).

¹⁶⁹ ISS PRELIMINARY REPORT, *supra* note 152, at 3 (“[P]ay-for-performance concerns . . . were identified [as the primary driver] at 27 companies.”). For example, shareholders at Constellation Energy gave only 38.6% support for the company pay practices, which included an increase in CEO pay from \$6.7 million in 2009 to nearly \$16 million in 2010, despite one-year and three-year share returns of negative 10.3% and negative 30.6%.

¹⁷⁰ *Id.*

¹⁷¹ *Id.* For other factors that contributed to a negative shareholder vote, see Ferracone & Harris, *supra* note 166, at 2.

Stanley Black & Decker (outsized time-based and guaranteed equity award, and failure to address low voting support for two compensation committee members in 2010); Nabors Industries (pay-for-performance concerns, coupled with pay significantly above the peer median); Hewlett-Packard (concerns over the new CEO's hire package in conjunction with a track record of generous severance payments for departing executives, and the CEO's participation in selecting new board members); Janus Capital Group (outsized sign-on bonus for the new CEO, despite lagging shareholder returns); Jacobs Engineering Group (pay-for-performance concerns); and Masco (pay-for-performance).¹⁷²

Pay-for-performance issues—and not other questions of pay design—seemed to have been dominant on the minds of shareholders. The Conference Board study on the first 100 filers found that factors other than the pay-performance relationship seemed mostly irrelevant in shareholder votes. At the studied companies, say-on-pay votes did not vary based on such pay practices as excise tax gross-ups, perquisites, stock ownership guidelines, and clawbacks.

For example, companies that offered executives an excise tax gross-up received about the same say-on-pay support (92%) as companies without such a practice (89%). Likewise, companies with disclosed clawback policies received as much say-on-pay support (89%) as companies without such policies (86%). Nonetheless, when combined with pay-performance concerns, the practices may have swung some votes. For example, the couple of companies among the first 100 filers that added perquisites received much less say-on-pay support (68%) than the ten companies that eliminated or reduced perquisites (93%).¹⁷³

A study of failed say-on-pay votes prepared for the Council of Institutional Investors confirmed the importance of the pay-performance relationship.¹⁷⁴ The study—based on interviews with institutional investors, investment-management firms, proxy advisers and solicitors, and company officials—identified “pay for performance” disconnects as the reason for the failed vote 92% of the time.¹⁷⁵

One-year and three-year total shareholder returns (TSRs) were a strong predictor of say-on-pay voting—with strong TSRs resulting in high levels of shareholder support and weak TSRs resulting in low

¹⁷² ISS PRELIMINARY REPORT, *supra* note 152, at 3.

¹⁷³ Miller & Assayag, *supra* note 159, at 5.

¹⁷⁴ Ferracone & Harris, *supra* note 166, at 1.

¹⁷⁵ Other reasons cited were “poor pay practices” (cited 57% of the time), perceived “poor disclosure” by the company (cited 35% of the time), and unreasonably or inappropriately high compensation (cited 16% of the time). *Id.* at 2.

levels of shareholder support.¹⁷⁶ Some have even suggested that say-on-pay may be more a “say on performance.”¹⁷⁷

Equilar compared the voting results on say-on-pay proposals based on levels of CEO pay and TSR. Companies with one-year TSR in the highest two quartiles and CEO pay in the lowest quartile received the strongest say-on-pay support—approximately 95.8%. Companies with one-year TSR in the lowest quartile and CEO pay in the highest quartile received the weakest say-on-pay support—approximately 73.9%.¹⁷⁸

TABLE 6: SAY-ON-PAY VOTING RESULTS AMONG FIRST 100 COMPANIES AND CEO PAY/PERFORMANCE

CEO Total Compensation in 2010

One-Year TSR	Q4	Q3	Q2	Q1 (Top)
Q1 (Top)	94.1%	90.8%	92.5%	92.2%
Q2	97.5%	86.1%	95.5%	84.8%
Q3	93.7%	88.0%	82.1%	90.4%
Q4	88.2%	82.4%	87.5%	73.9%

Nonetheless, short-term TSR performance—though a key factor in shareholder voting support—proved not to be outcome determinative. For example, of the many companies receiving 90% or more shareholder say-on-pay support, about 21% had TSR performance in the bottom quartile. But the importance of performance results is inescapable, as is made clear in the following chart by Equilar:¹⁷⁹

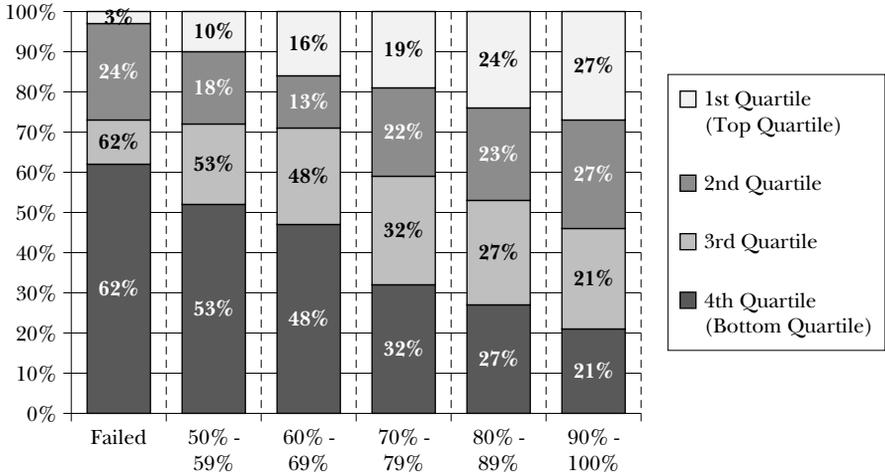
¹⁷⁶ Miller & Assayag, *supra* note 159, at 4. In fact, the only two companies in the study not receiving majority support for their pay programs had average one-year TSRs of negative 13.3% and average three-year TSRs of negative 13.0%. This is compared to overall TSRs for the first 100 filers of average one-year TSRs of positive 16.5% and three-year TSRs of negative 4.6%.

¹⁷⁷ See Joseph E. Bachelder III, *Say-on-Pay Under Dodd-Frank*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Sept. 17, 2011, 8:19 AM), <http://blogs.law.harvard.edu/corpgov/2011/09/17/say-on-pay-under-dodd-frank>.

¹⁷⁸ Miller & Assayag, *supra* note 159, at 4 (reporting figures from ClearBridge Compensation Group, which identified average percentage of shareholders voting for the executive compensation program).

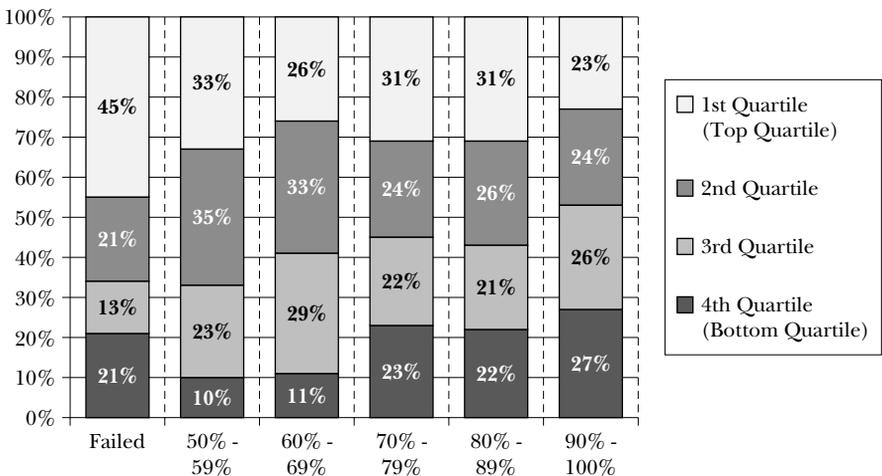
¹⁷⁹ ISS PRELIMINARY REPORT, *supra* note 152, at 3.

FIGURE 3: DISTRIBUTION OF COMPANIES BY PERFORMANCE AND LEVELS OF SAY-ON-PAY SUPPORT



More relevant than overall levels of CEO pay may have been increases in CEO pay. One-year growth in pay is a factor used by proxy advisory firms in analyzing pay practices, making companies with above-average CEO pay increases more susceptible to negative votes than those with below-average CEO pay increases. The following table produced by Equilar makes this clear:¹⁸⁰

FIGURE 4: ONE-YEAR CEO PAY GROWTH



¹⁸⁰ Miller & Assayag, *supra* note 159, at 5.

This correlation was particularly pronounced for companies with failed say-on-pay votes. At 27 of the 37 such companies, TSR had been negative and CEO pay had increased in the prior year.¹⁸¹ In short, shareholders showed their displeasure that executives should win big while shareholders lost big.

In sum, shareholders focused on “outlier” companies with high overall pay, low total shareholder return compared to their industry or peers, or both. This suggests that say on pay may play an important role in helping to discipline pay practices at some firms where they vary significantly from those observed elsewhere.

3. *ISS Recommendations Not Followed Reflexively*

Despite predictions that shareholders (especially institutional shareholders) would reflexively follow ISS recommendations regarding say-on-pay proposals, failed say-on-pay votes were far fewer than had been recommended by ISS.¹⁸² While ISS recommended negative say-on-pay votes at 285 companies (13% of the companies it reviewed), only 37 companies—or 1.6%—conducting a say-on-pay vote failed to receive majority shareholder support.¹⁸³

More than 86% of the companies that ISS targeted with an “against” recommendation received majority support for their say-on-pay proposal.¹⁸⁴ But even though ISS did not carry the day at most companies it targeted with an “against” recommendation, all the companies with a failed say-on-pay vote were on the ISS target list. In addition, say-on-pay support at companies on the ISS target list was only 71.8%—on average 25% lower than for companies receiving a favorable ISS recommendation¹⁸⁵—which is consistent with our pre-Dodd-Frank findings in Table 4, as management would always have recommended that shareholders vote in favor of their proposal.

The 2011 ISS proxy-voting guidelines were essentially unchanged from those of 2010 on the issue of management say-on-pay propos-

¹⁸¹ *Id.* at 4.

¹⁸² Littenberg, Damania & Neidig, *supra* note 162, at 4.

¹⁸³ *See id.* at 3 (identifying ISS “against” recommendations at 276 companies and “for” recommendations at 1,949 companies). The rate of negative say-on-pay voting recommendations by Glass Lewis, the other major proxy advisory firm, apparently was similar to that of ISS. *See* James D.C. Barrall & Alice M. Chung, *Say on Pay in the 2011 Proxy Season: Lessons Learned and Coming Attractions for U.S. Public Companies*, DIRECTOR NOTES (Conference Bd.), July 2011, at 5, http://www.lw.com/upload/pubContent/_pdf/pub4251_1.pdf (noting that Glass Lewis is less transparent than ISS in disclosing the firm’s voting recommendations).

¹⁸⁴ Littenberg, Damania & Neidig, *supra* note 162, at 4.

¹⁸⁵ *Id.* at 5. This is in comparison to 42% support at companies with a failed say-on-pay vote and 92.9% support for companies receiving a “for” recommendation from ISS. *Id.*

als.¹⁸⁶ ISS based its negative recommendations in the 2011 proxy season mostly on perceived disconnects between pay and performance, with specific attention to year-over-year increases and long-term trends in executive pay compared to shareholder returns.¹⁸⁷ Interestingly, shareholders seemed indifferent to ISS concerns about non-pay-for-performance policies—such as tax gross-ups, change-in-control definitions, severance pay, and relocation payments. Even though ISS labeled some of these practices as “problematic,” shareholders seemed unmoved. In particular, shareholders seemed unconcerned about pay practices that ISS felt “could incentivize excessive risk-taking,” such as guaranteed bonuses and annuity grants, lucrative severance packages, and disproportionate pensions.¹⁸⁸

Nonetheless, shareholders did seem concerned at some companies about the question of board responsiveness to shareholder pay concerns—one of the factors behind an ISS “against” recommendation.¹⁸⁹ Although it may be too early to tell, the ways in which management responded during the 2011 proxy season to ISS negative voting recommendations suggest that management believes this could be a basis for shareholder voting dissatisfaction in the future.

B. Impact of Say on Pay

One voting season a trend does not make. Yet, according to some commentators, the 2011 proxy season was a watershed event in U.S. corporate governance. The say-on-pay votes mandated by Dodd-Frank, in these commentators’ eyes, appear to have catalyzed greater management attention to shareholder concerns, an increased shareholder interest in voting on corporate governance, and a broader dialogue on pay issues between management and shareholders (and proxy advisory firms).¹⁹⁰ SEC Commissioner Luis Aguilar commented that management is “putting in more performance-based compensa-

¹⁸⁶ ISS GOVERNANCE SERVS., 2011 U.S. PROXY VOTING GUIDELINES SUMMARY 37 (2011), available at <http://www.issgovernance.com/files/ISS2011USPolicySummaryGuidelines20110127.pdf> [hereinafter ISS 2011 GUIDELINES]. These guidelines are in line with the five “global principles” previously identified by ISS in evaluating pay programs: (1) maintaining a pay-for-performance alignment, (2) avoiding “pay for failure,” (3) maintaining an effective compensation committee, (4) providing shareholders clear, comprehensive pay disclosures, and (5) avoiding “inappropriate” pay for outside directors. Not surprisingly, the 2011 guidelines no longer mention shareholder-sponsored say-on-pay proposals, as they are now moot.

¹⁸⁷ Littenberg, Damania & Neidig, *supra* note 162, at 4.

¹⁸⁸ ISS 2011 GUIDELINES, *supra* note 186, at 39.

¹⁸⁹ See TED ALLEN ET AL., INSTITUTIONAL S’HOLDER SERVS., 2011 U.S. POSTSEASON REPORT 30–33 (2011) (describing instances in which lack of responsiveness to prior shareholder opposition to a company’s pay policies or compensation committee members contributed to opposition to board nominees).

¹⁹⁰ Luis A. Aguilar, Comm’r, SEC, Speech by SEC Commissioner—An Inflection Point: The SEC and the Current Financial Reform Landscape (June 10, 2011).

tion plans and they are addressing items that shareholders often criticized, such as: excessive severance; perks; federal income tax payments; and pensions. For example, approximately 40 of the Fortune 100 companies have eliminated policies that had the company pay certain tax liabilities of executives.”¹⁹¹

Going beyond the reasons articulated in support of say on pay before the enactment of Dodd-Frank, say on pay has been said to: (1) “bring[] greater attention to executive pay policies and practices,” (2) make “shareholders feel more connected with the process of setting executive pay,” and (3) increase the attention by directors and management to whether executive pay is consistent with shareholders’ views.¹⁹²

One thing that did not happen during the 2011 proxy season, however, was a shareholder backlash at increasing levels of executive pay. Despite ISS’s intention that say-on-pay proposals be evaluated, in part, on the basis of whether inappropriate “peer group benchmarking” had led to the ratcheting up of executive pay, the upward spiral in CEO pay seemed not to be on the minds of shareholders.¹⁹³

As the dust settles on the inaugural year of Dodd-Frank’s say-on-pay mandate, advisors to public companies have identified some early lessons. For example, the process for setting executive pay in public companies now lives under the shadow of say-on-pay votes. As the Conference Board advised corporate directors: “[C]ompanies need to take [the trends and emerging regulatory landscape] into account as they make compensation and governance decisions in 2011 that will best position them for the 2012 proxy season and SOP votes to come.”¹⁹⁴

1. *Pay Programs Changed in Anticipation of Say on Pay*

Even before the say-on-pay vote, management at many companies made changes to the substance and disclosure of their pay programs. According to a study by the Conference Board on pay practices at the 100 companies in the Fortune 500 that were first to file their 2011 proxy filings, many of these companies changed the terms of their pay programs, particularly to more clearly align pay to performance. In addition, many companies revised the content (and their attitudes) toward company disclosure of executive pay in the CD&A filed with the annual meeting proxy materials.

¹⁹¹ *Id.* (footnotes omitted).

¹⁹² Bachelder, *supra* note 177.

¹⁹³ See ISS 2011 GUIDELINES, *supra* note 186, at 38 (assessing whether benchmarking is sound); see also Cheffins & Thomas, *supra* note 6, at 310–14 (predicting that shareholders would not recognize increasing CEO pay).

¹⁹⁴ Barrall & Chung, *supra* note 183, at 1.

In some cases companies changed their executive pay programs—sometimes retroactively—reducing non-performance-based pay (such as tax gross-ups, executive perquisites, and large severance arrangements) or enhancing the pay-for-performance relationship.¹⁹⁵ According to the Conference Board, about 46% of the companies in the study eliminated or reduced non-performance-based pay in anticipation of the 2011 say-on-pay vote.¹⁹⁶ The pay-for-performance relationship was enhanced with changes to company guidelines on CEO stock ownership (six companies)¹⁹⁷ and with revised standards for “clawbacks” of executive pay after a financial restatement (34 companies).¹⁹⁸

Disclosure of executive pay in 2011 also went through significant changes, as more companies sought to make their proxy disclosure not only compliant, but informative and persuasive. Many companies used the CD&A to tell a clearer story and offer performance-based rationale for their pay programs. Most companies in the Conference Board study (65, up from 30 the year before) included executive summaries on their pay-performance relationship, often with graphical representations.¹⁹⁹ Some companies went one step further and provided “layered” disclosure, with a proxy summary at the beginning of the proxy statement that highlighted pay decisions and company performance in 2010.²⁰⁰

2. *Jaw-Boning in Response to Negative ISS Recommendations*

One of the most interesting aspects of the 2011 proxy season was the give-and-take that occurred at many companies whose pay programs received negative say-on-pay recommendations by proxy advisory firms. Rather than counting on shareholder loyalty, management at some such companies engaged with shareholders following an “against” recommendation. As one report observed, “[w]ith addi-

¹⁹⁵ Miller & Assayag, *supra* note 159, at 2.

¹⁹⁶ *Id.* The Conference Board found that changes to non-performance-based pay focused on elimination for excise tax gross-ups (at 40 companies, both existing and future pay packages), reduction or elimination of such executive perquisites as country club memberships and financial planning (10 companies), and reduction of severance multiples from 3x to 2x cash compensation (3 companies). *Id.*

¹⁹⁷ *Id.* Six companies in 2011 increased their guidelines on CEO stock ownership to specify a range of 6x to 10x salary, rather than the more common 5x salary. *Id.*

¹⁹⁸ *Id.* Dodd-Frank requires the SEC to adopt enhanced “clawback” standards. *Id.* In anticipation of these changes, companies changed their clawback provisions, expanding the list of executives subject to clawback and broadening the items subject to clawbacks for more company executives. *Id.*

¹⁹⁹ *Id.* For example, some companies included a comparison TSR and CEO pay at the beginning of the CD&A, anticipating this requirement under new SEC rules. Other companies included in the CD&A comparisons of company TSR with composite TSRs for peers or a benchmark index—something already required under Form 10-K. *Id.* at 3.

²⁰⁰ *Id.* at 5.

tional pressure from proxy-advisory firm recommendations, the new law has led many companies to increase their communication with shareholders and re-evaluate their compensation and corporate-governance practices.”²⁰¹

Some companies filed supplemental proxy disclosures following a negative recommendation—including slideshow presentations, letters to proxy advisory firms taking issue with information or analysis in their reports, and letters to shareholders defending their pay-for-performance orientation.²⁰² Engagement with shareholders bore fruit. Companies that responded to an ISS “against” recommendation with additional disclosure eventually received a favorable say-on-pay vote.

Nonetheless, many companies receiving a negative say-on-pay recommendation were unprepared to quickly ramp up their shareholder outreach.²⁰³ Such companies have been advised to “hone their messaging and outreach strategy well in advance of next year’s annual meeting.”²⁰⁴

3. *Management Response to Say-on-Pay Rebukes*

Management at many companies also seems to be responding more to say-on-pay rebukes. For example, two companies that voluntarily put say on pay on the ballot in 2010 and received majority opposition—Occidental Petroleum and KeyCorp—changed their pay practices.²⁰⁵ As a result, shareholders gave significant support to the revised pay packages at these firms—with votes of 91.3% and 86.7% support, respectively, in 2011.²⁰⁶

Some companies with failed say-on-pay votes in 2011, however, have chosen not to change their pay practices, but instead to blame the proxy advisory firms.²⁰⁷ Time will tell how well this strategy works.

²⁰¹ *An Analysis of Voting Results and Performance at Russell 3000 Companies*, *supra* note 152.

²⁰² See Miller & Assayag, *supra* note 159, at 3 (reporting such action at seven companies among the first 100 to file proxy materials in 2011, all of which eventually received a favorable say-on-pay vote); Littenberg, Damania & Neidig, *supra* note 162, at 6.

²⁰³ Littenberg, Damania & Neidig, *supra* note 162, at 6 (noting that such companies failed to analyze shareholder demographics, develop an outreach strategy, and send a clear message).

²⁰⁴ See *id.*

²⁰⁵ See ISS PRELIMINARY REPORT, *supra* note 152, at 5. At Occidental, the company cut CEO long-term incentive opportunities by 70%, expanded peer benchmarks, and reduced award opportunities for other executives. *Id.* This was apparently also the case for the 1% of companies under the TARP program that had a failed say-on-pay vote in 2010. See Littenberg, Damania & Neidig, *supra* note 162, at 7.

²⁰⁶ ISS PRELIMINARY REPORT, *supra* note 152, at 5.

²⁰⁷ See Littenberg, Damania & Neidig, *supra* note 162, at 7.

4. *Fewer Votes Against Director Reelection*

According to ISS, say on pay may have changed the nature of the shareholder–management dialogue, with shareholders resorting less often in 2011 to “no” or “withhold” votes on directors sitting on compensation committees with controversial pay practices.²⁰⁸ That is, instead of expressing displeasure with executive pay by voting against particular directors, the say-on-pay vote allows shareholders to speak directly about the pay practices themselves.

The evidence in support of these claims is that the 2011 proxy season saw directors reelected with the highest average support in the past five years.²⁰⁹ While 87 directors failed to receive majority support in 2010, and 89 directors in 2009, the number of directors failing to receive such support dropped to 43 in 2011.²¹⁰ And instead of membership on a controversial compensation committee, other reasons dominated for why these directors failed to receive majority support, such as poor attendance at meetings, failure to put a poison pill to a shareholder vote, and failure to act on majority-supported shareholder resolutions.²¹¹

Nonetheless, shareholder dissatisfaction with directors on the compensation committees at companies with failed say-on-pay votes was relatively high. Such directors received on average 13.5% fewer votes than other directors on the ballot.²¹² This compared to only 2.4% fewer votes for compensation-committee directors at companies that received a negative ISS recommendation, but had a passing say-on-pay vote.²¹³

This may put pressure on compensation committee members at companies with failed say-on-pay votes. ISS has indicated it may recommend against reelection of such members if the company has not addressed the ISS say-on-pay concerns.²¹⁴

²⁰⁸ See ISS PRELIMINARY REPORT, *supra* note 152, at 14–15. This pattern was in line with ISS voting guidelines for 2011, which called on shareholders to vote to express dissatisfaction with controversial pay practices by voting against management’s say-on-pay proposal, “rather than withholding or voting against the compensation committee.” But when management did not offer a say-on-pay proposal, ISS suggested that a “negative vote will apply to members of the compensation committee.” ISS 2011 GUIDELINES, *supra* note 186, at 37.

²⁰⁹ Littenberg, Damania & Neidig, *supra* note 162, at 5 (crediting data attributed to ISS).

²¹⁰ ISS PRELIMINARY REPORT, *supra* note 152, at 14.

²¹¹ See *id.*

²¹² Littenberg, Damania & Neidig, *supra* note 162, at 5.

²¹³ See *id.* (comparing, among companies receiving a negative ISS recommendation, those with failed say-on-pay votes and those with passing say-on-pay votes).

²¹⁴ See *id.*

5. *Lawsuits at Companies with Failed Say-on-Pay Votes*

Although Dodd-Frank specifically disclaimed creating any new or enhanced director fiduciary duties arising from say-on-pay votes,²¹⁵ negative “say on votes” have led to shareholder suits—as some predicted. Of the 37 firms with a negative say-on-pay vote in 2011, eight have been subject to lawsuits alleging breaches of director fiduciary duties and corporate waste.²¹⁶ Nonetheless, the proportion of firms sued after a negative say-on-pay vote is lower than that for 2010, when two of the three negative say-on-pay votes resulted in derivative actions.²¹⁷

The actions generally claim that increases in executive pay were at odds with the firm’s stated pay-for-performance philosophy and that the directors violated their fiduciary duties by disregarding the negative say-on-pay vote in failing to rescind the increased executive pay.²¹⁸ Despite predictions that the lawsuits would be denied as frivolous, and some dismissals, at least one court has denied a motion to dismiss²¹⁹—leading to questions about the protection of the business judgment rule in such cases.²²⁰

²¹⁵ See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1900 (2010) (adding new section 14A to the Securities Exchange Act of 1934). Section 14A states:

(c) RULE OF CONSTRUCTION.—The shareholder vote referred to in subsections (a) and (b) shall not be binding on the issuer or the board of directors of an issuer, and may not be construed—

- (1) as overruling a decision by such issuer or board of directors;
- (2) to create or imply any change to the fiduciary duties of such issuer or board of directors;
- (3) to create or imply any additional fiduciary duties for such issuer or board of directors; or
- (4) to restrict or limit the ability of shareholders to make proposals for inclusion in proxy materials related to executive compensation.

Id.

²¹⁶ See Bachelder, *supra* note 177 (reporting that “at least nine shareholder derivative actions (two of them against a single corporation, Janus Capital Group) have been filed based on negative shareholder say-on-pay votes in 2011”); see also Jessica Lochmann Allen, Michael Schultz & Steven Vazquez, *The Impact of the ‘Say-on-Pay’ Vote on the CEO Evaluation Process*, 14 Corp. Governance Rep. (BNA) 120 (Oct. 3, 2011) (stating that demand letters have been submitted at other companies, suggesting further litigation absent settlement).

²¹⁷ See Bachelder, *supra* note 177 (stating that both 2010 cases are reportedly settled).

²¹⁸ See Allen, Schultz & Vazquez, *supra* note 216 (reporting that some cases allege that the negative shareholder vote itself rebuts the business judgment rule).

²¹⁹ See NECA-IBEW Pension Fund v. Cox, No. 1:11-cv-451, 2011 WL 4383368, at *1, *4 (S.D. Ohio Sept. 20, 2011) (representing the first derivative suit against officers and directors of Cincinnati Bell); Allen, Schultz & Vazquez, *supra* note 216.

²²⁰ See Laura G. Thatcher, ‘Cincinnati Bell’ and ‘Beazer’: What Do These Opposite Say-on-Pay Decisions Bode for the Future?, 9 Corp. Counsel Wkly. (BNA) 1251 (Oct. 21, 2011); Kenneth B. Davis, Jr. & Keith L. Johnson, *Say-On-Pay Lawsuits—Is This Time Different?* (Univ. Wisc. Law Sch. Legal Stud. Research Paper Series, Paper No. 1182, 2012), available at <http://ssrn.com/abstract=1972406>; William Alan Nelson II, *Ending the Silence: Shareholder Derivative Suits and Amending the Dodd-Frank Act so “Say on Pay” Votes May Be Heard in the Boardroom*, U. MIAMI BUS. L. REV. (forthcoming), available at <http://ssrn.com/abstract=1988544>.

Fear of litigation following a failed say-on-pay vote has led corporate advisers to recommend that firms change the CEO performance evaluation process, thus positioning the company to avoid a negative vote or to defend against such a lawsuit.²²¹ Directors have also been advised to “be especially sensitive to the deliberative process leading up to pay decisions and the way in which that process is documented.”²²²

Not only have directors at companies with failed say-on-pay votes been sued, but so too have the company’s pay consultants for allegedly aiding and abetting the breaches of director duties as well as purportedly breaching their consulting agreements.²²³ Thus, pay consultants will have an even greater incentive to help their clients avoid a negative say-on-pay vote, perhaps demanding higher consulting fees and indemnification clauses in future consulting agreements with at-risk clients.²²⁴

6. *Preparations for 2012 Proxy Season*

Companies and various voting advisors are already preparing for the 2012 proxy season.²²⁵ Some companies with failed say-on-pay votes in 2011 have moved to address the concerns identified by shareholders.²²⁶ But even companies that received strong say-on-pay support are said to be planning or considering changes in their pay-setting process in preparation for the 2012 proxy season.²²⁷

In particular, firms with low, though successful, say-on-pay votes have been advised to focus more attention on their pay practices. For example, ISS predicts that companies that in 2011 received more than 30% say-on-pay opposition can expect “greater attention” in 2012.²²⁸ According to the Conference Board, governance experts conclude that “companies with less than 75 percent to 80 percent support for their SOP proposals this year remain at risk in 2012.”²²⁹

²²¹ See Allen, Schultz & Vazquez, *supra* note 216.

²²² Littenberg, Damania & Neidig, *supra* note 162, at 6.

²²³ See *id.*

²²⁴ See *id.*

²²⁵ See *Inaugural Say-on-Pay Proxy Season Brings Few Problems for Most Companies, Although Many Plan for Changes for 2012, Towers Watson Survey Finds*, TOWERS WATSON (July 28, 2011) [hereinafter *Towers Watson Survey*], <http://www.towerswatson.com/united-states/press/5080>.

²²⁶ See, e.g., ISS PRELIMINARY REPORT, *supra* note 152, at 5 (providing the following examples: Helix Energy Solutions, which added performance metrics to its cash bonus program, and Umpqua Holdings, which retroactively added performance conditions to previously awarded restricted stock and stock options).

²²⁷ See *Towers Watson Survey*, *supra* note 225.

²²⁸ ISS PRELIMINARY REPORT, *supra* note 152, at 5.

²²⁹ Littenberg, Damania & Neidig, *supra* note 162, at 5 (describing the view of Francis Byrd, head of Corporate Governance and Risk Advisor at Laurel Hill Advisory Group).

Some directors may have heard this message. According to the 2011 Annual Corporate Director Survey released by PricewaterhouseCoopers, of 834 directors surveyed 72% said they would reconsider executive pay plans even when the plan had received majority shareholder support.²³⁰ In addition, 24% of board members said they had increased board-level communications with proxy advisory firms over the past year.²³¹

Corporate lawyers are advising their clients—both to avoid lawsuits and to better make their case with shareholders—to initiate formal measures for CEO evaluation based on performance in light of the company's current strategy, goals, and market position.²³² Such evaluation, if undertaken on a regular basis, “may strengthen the case for a CEO compensation decision based on longer-term performance despite a ‘blip’ in the company's performance.”²³³ Recognizing the weight shareholders have placed on pay-for-performance, corporate advisers have urged compensation committees to clearly articulate and then adhere to a pay-for-performance philosophy, “focusing on the ways in which strong performance is rewarded and weak performance can be penalized.”²³⁴

Likewise, corporate advisers have urged corporate managers “to understand what will drive the voting recommendations of Institutional Shareholder Services (ISS) and other proxy advisory firms, which are followed by many institutional investors.”²³⁵ Among the ISS voting principles mentioned is that companies should provide their shareholders with “clear, comprehensive compensation disclosures”—particularly on their pay-for-performance philosophy and practices.²³⁶

In a recent far-ranging memo by Wachtell, Lipton, Rosen and Katz, the law firm advises clients how to “Win the Say on Pay Vote.”²³⁷ Directed not only to companies that had low shareholder support for

²³⁰ See *Annual Corporate Director Survey 2011 Findings: Boards Respond to Stakeholder Concerns*, PRICEWATERHOUSECOOPERS 2, 4, http://download.pwc.com/ie/pubs/2011_annual_corporate_directory_survey.pdf (last visited Apr. 8, 2012).

²³¹ See *id.* at 4.

²³² See Littenberg, Damania & Neidig, *supra* note 162, at 6–7 (advising clients on how to prepare for say-on-pay votes and possible litigation arising from such votes).

²³³ Allen, Schultz & Vazquez, *supra* note 216 (mentioning “tone at the top”—where management performance is regularly tracked and strong performance rewarded—and developing evaluation criteria based on short-term financial metrics and long-term nonfinancial metrics, such as acquisition strategy or executive succession planning).

²³⁴ *Id.*

²³⁵ *Id.*

²³⁶ *Id.*

²³⁷ See Jeremy L. Goldstein, *How to Win the Say on Pay Vote*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Dec. 1, 2011, 9:31 AM), <http://blogs.law.harvard.edu/corpgov/2011/12/01/how-to-win-the-say-on-pay-vote> (posting material based on a Wachtell, Lipton, Rosen & Katz memorandum by Jeremy L. Goldstein, Jeannemarie O'Brien & David E. Kahan).

their say-on-pay proposals, the memo urges companies that “passed last year’s vote with flying colors” to prepare for the upcoming proxy season given changes in the ISS voting criteria on say on pay.²³⁸

The Wachtell Lipton memo describes changes ISS has proposed to its say-on-pay voting guidelines, including revisions to its peer group analysis (reducing the number of comparable firms to more closely track each company’s market cap and revenues) and to its measures of pay alignment with TSR performance (on a relative basis over one- and three-year periods and an absolute basis looking at rates of pay change).²³⁹ In anticipation of these changes, the memo outlines five steps that companies should take to “best position” themselves for the upcoming proxy season’s say-on-pay votes: (1) understand how companies’ pay programs align with voting policies of major shareholders and ISS; (2) consider revising pay programs based on shareholder feedback, recognizing that one revision may necessitate others; (3) begin work on the CD&A disclosure and use an executive summary, both emphasizing pay for performance; (4) consider opening lines of communications with shareholders, particularly if shareholder support in 2011 had been weak; and (5) be prepared to respond to ISS voting recommendation after the company issues its proxy disclosure, including assembling a task force for that purpose and taking the case directly to shareholders.

SUMMARY AND POLICY IMPLICATIONS

The results of our empirical analysis of the pre-Dodd-Frank shareholder-sponsored proposals on executive pay practices and management-sponsored say-on-pay proposals shed some light on how the enactment of mandatory say on pay will affect shareholder voting and corporate governance more generally. We find that pre-Dodd-Frank precatory executive pay proposals submitted by shareholders under Rule 14a-8, including shareholder proposals recommending company-by-company adoption of advisory say-on-pay votes, attracted some shareholder support, but generally did not obtain majority approval.²⁴⁰ Nonetheless, proposals requesting that shareholders approve certain pay practices (other than the overall pay levels) and say-on-pay proposals received the highest levels of support of shareholder-sponsored proposals related to executive pay, suggesting shareholder interest in having more input in the pay-setting process.²⁴¹

Management-sponsored say-on-pay proposals in the pre-Dodd-Frank period attracted much higher levels of support—more than

²³⁸ See *id.*

²³⁹ See *id.*

²⁴⁰ See *supra* Part III.A.1.

²⁴¹ See *supra* Part III.A.2.

twice as high as the average for shareholder-sponsored proposals.²⁴² Based on this evidence, we projected that management-sponsored say on pay after Dodd-Frank would be likely to attract high levels of shareholder support and that only a relatively small fraction of such proposals were likely to fail to attract majority support. In fact, this is what happened in the 2011 proxy season.²⁴³

Turning to the influence of an ISS “for” recommendation on executive pay matters, our data suggest that in the pre-Dodd-Frank period, this type of ISS voting recommendation increased shareholder support by about 20% for most categories of executive-pay advisory proposals.²⁴⁴ This ISS effect seems to be consistently true for management-sponsored say-on-pay proposals, as well as most categories of shareholder-sponsored proposals. However, once we take into account the differing recommendations issued by management and ISS, the impact of a favorable ISS recommendation is much smaller for management-sponsored say-on-pay proposals compared to shareholder-submitted say-on-pay proposals. This suggests that ISS may be less influential than commonly thought on this type of proposal. We expect that this trend is also likely to persist in the post-Dodd-Frank period, and we plan to test for it once we obtain the voting data from ISS for the 2011 proxy season.

Looking to the information that is available, we find that shareholders post-Dodd-Frank gave broad support to executive pay packages. While this suggests that the voting gesture mandated by law might have been mostly empty, placement of the issue on the company’s ballot may have changed the dynamics of the shareholder–management dialogue. Shareholder votes focused negative attention on poorly performing firms with relatively high pay levels. During the 2011 proxy season, even before the annual meeting at which the shareholders would have their say on pay, management at a number of companies either changed the company’s pay practices in response to the possibility of an unfavorable shareholder vote, or offered additional disclosure explaining pay practices that had come onto the shareholder radar screens.²⁴⁵ In short, the mandate for widespread say-on-pay votes may have led shareholders to become more attentive to pay issues and may have led management to become more responsive to shareholder concerns.

Has Dodd-Frank provided a stronger tool for the expression of shareholder views on executive pay at targeted firms and opened or widened channels of communication between management and

²⁴² See *id.*

²⁴³ See *supra* Part IV.A.1.

²⁴⁴ See *supra* Part III.B.

²⁴⁵ See *supra* Part IV.B.1–3.

shareholders on the issue? There is already anecdotal evidence for this. During this past proxy season, management facing ISS recommendations against their say-on-pay proposals mounted informational campaigns disputing ISS findings or seeking to explain their pay structures to institutional shareholders.²⁴⁶ Further, management at companies with high executive pay and relatively weak stock price performance may want to spend more time explaining their pay practices to their shareholders. We look forward to exploring these issues further in our future research.

²⁴⁶ See Barrall & Chung, *supra* note 183, at 6; Littenberg, Damania & Neidig, *supra* note 162, at 6.