

Preliminary 2011 U.S. Postseason Report

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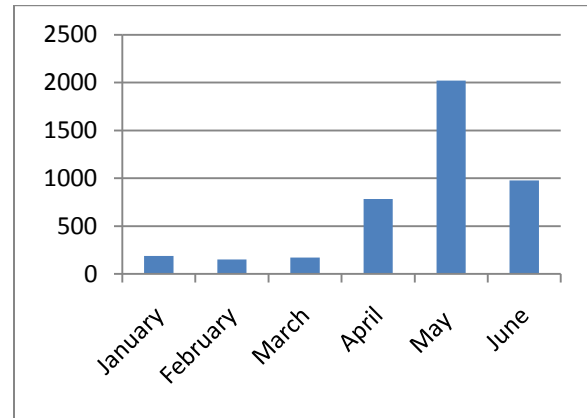
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Figure 1: Number of U.S. Annual Meetings Covered by ISS During Proxy Season 2011



Key Takeaways

- During the first year of advisory votes on executive compensation under the Dodd-Frank Act, investors overwhelmingly endorsed companies' pay programs, providing 91.2 percent support on average.
- Shareholders voted down management "say on pay" proposals at 37 Russell 3000 companies, or just 1.6 percent of the total that reported vote results. Most of the failed votes apparently were driven by pay-for-performance concerns.
- "Say on pay" votes increased investors' workloads, but spurred greater engagement by companies and prompted some firms to make late changes to their pay practices to win support.
- Investors overwhelmingly supported an annual frequency for future pay votes. As of June 30, annual votes had garnered majori-

ty (or plurality) support at 1,792 companies in the Russell 3000 index, as compared to triennial votes, which won the greatest support at 412 companies.

- Among governance proposals, the biggest story of this year was the greater support for shareholder proposals that seek board declassification. These resolutions averaged 73.5 percent support, up more than 12 percentage points from 2010, and won majority support at 22 out of 23 large-cap firms.
- Majority voting proposals averaged almost 60 percent support, while proponents reached settlements with more than 30 firms. Independent chair proposals fared better this year, winning majority support at four companies.
- There were fewer shareholder proposals to repeal supermajority rules, as more companies put management proposals on the ballot.
- Investor support for shareholder resolutions on environmental and social (E&S) issues continues to rise. This year, there was a 20.6 percent average approval rate for these proposals, the first time this support level had reached the 20 percent mark. Five proposals received a majority of votes cast, a new record.
- The arrival of "say on pay" contributed to a significant decline in shareholder opposition to directors. As of June 30, just 43 directors at Russell 3000 firms had failed to win majority support, down from 87 in the same period in 2010.
- Poor meeting attendance, the failure to put a poison pill to a shareholder vote, and the

failure to implement majority-supported shareholder proposals were among the reasons that contributed to majority dissent against board members this year.

Most Firms Receive Broad Support on Pay

During the first year of advisory votes on executive compensation under the Dodd-Frank Act, investors have overwhelmingly endorsed companies' pay programs, providing 91.2 percent support on average (based on "for" and "against" votes).

This support exceeds the 89.2 percent average approval in 2010, when "say on pay" votes were mandated only at U.S. government-supported financial firms. While the median total compensation for CEOs at S&P 500 firms increased by more than 33 percent last year, those pay increases haven't translated into more shareholder opposition, in part because of greater engagement by issuers. Dozens of companies have released supplemental proxy materials to address investor concerns or made late changes to their pay practices to win shareholder support.

So far this season, S&P 500 companies have averaged 88.6 percent support, which is slightly less than the 91.8 percent approval for issuers in the Russell 3000 index, according to ISS data.

Failed Votes

So far this year, shareholders have voted down management "say on pay" proposals at 37 U.S.-listed companies in the Russell 3000 index, or just 1.6 percent of the more than 2,200 companies in the index that have reported vote results. This list includes two companies (Cutera and Dex One) that since have left the Russell 3000 index. This list doesn't include two issuers (Cooper Industries

and Doral Financial), where the advisory votes would have failed if abstentions had been included in the calculation.

Of the 37 companies with failed votes this year, 11 received less than 40 percent of the votes cast "for" and "against." Overall, eight S&P 500 companies and 29 Russell 3000 firms have failed to receive the required vote for approval of their executive pay programs.

The primary driver of these failed votes appears to be pay-for-performance concerns, which were identified at 27 companies. Investors appear to have voted their pocketbooks this season. Almost half of the failed-vote firms have reported double-digit negative three-year total share returns. Also contributing to investor dissent were such issues as tax gross-ups, discretionary bonuses, inappropriate peer benchmarking, excessive pay, and failure to address significant opposition to compensation committee members in the past.

The greatest number of failed advisory votes--about 25 percent--occurred in the energy sector, where companies such as Helix Energy Solutions, Superior Energy Services, and Constellation Energy received some of the lowest levels of shareholder support. At Constellation, shareholder support was only 38.6 percent, which appears to be due to pay-for-performance concerns at the company. CEO Mayo Shattuck's total compensation increased from \$6.7 million in 2009 to almost \$16 million in 2010. Meanwhile, the company's one- and three-year total shareholder returns were negative 10.3 percent and negative 30.6 percent, respectively. Shattuck's total pay increase was primarily due to a significant increase in his deferred compensation and pension value, and in the value of stock options granted to him. However, although his annual cash bonus declined by \$1.3 million (to \$1.7 million), he also received an award of time-based restricted shares valued at \$1.5 million in 2010, compared with none the prior year.

Shareholders also expressed significant opposition at homebuilders NVR, Beazer Homes USA, and M.D.C. Holdings, and there was majority dis-

sent at several real estate development firms, such as BioMed Realty Trust and Kilroy Realty.

Other well-known companies with failed "say on pay" votes this year include: 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).

It appears that most investors decided to use advisory votes as their primary means for expressing dissent over executive pay. Of the 37 companies with failed pay votes, just four had directors who also received majority opposition: Nabors, Stewart Information Services, Premiere Global Services, and Monolithic Power Systems. At three of the firms, there were other issues, such as poor meeting attendance, that contributed to investor dissent.

In addition to the failed votes, more than 30 companies received between 50 and 60 percent support for their pay practices, and may face greater shareholder scrutiny next year. Among those firms were Chesapeake Energy, Safeway, Lazard, Amgen, Devon Energy, and Allstate.

'Vote No' Campaigns

The American Federation of State, County, and Municipal Employees (AFSCME), which has long been active on compensation issues, waged "vote no" campaigns against the pay practices at five S&P 500 companies: Pfizer, Johnson & Johnson, Alcoa, ConocoPhillips, and ExxonMobil. Four of the firms received significant opposition; support at Pfizer and ConocoPhillips was less than 60 per-

cent, while Johnson & Johnson and Exxon Mobil received less than 70 percent approval. Alcoa, which made late changes to its pay practices to win investor support, received 84.2 percent approval, which came close to the 88.6 percent average for S&P 500 companies.

AFSCME primarily raised pay-for-performance concerns at several of the targeted companies, as well as other issues such as severance arrangements and pay magnitude concerns. At Pfizer, AFSCME argued that a \$4.5 million exit payment for retiring CEO Jeffrey Kindler, despite lagging shareholder returns during his tenure, raised concerns regarding the company's adherence to a pay-for-performance philosophy. At ConocoPhillips, the company provided for the payment of excise tax gross-ups in severance arrangements with two new executives, and continued the practice of crediting certain executives with additional years of service under its supplemental retirement plan.

Frequency of Votes

Also on this season's ballots were separate Dodd-Frank-mandated votes on the frequency of future "say on pay" votes. So far, shareholders have overwhelmingly supported an annual frequency. As of June 30, annual votes have garnered majority (or plurality) support at 1,792 companies in the Russell 3000 index, as compared to triennial votes, which won the greatest support at 412 companies, and biennial votes, which received the most support at just 16 firms.

Notably, management recommendations on pay vote frequency shifted throughout proxy season. In the early part of proxy season, from March to mid-April, management recommendations shifted away from triennial votes and toward annual votes, following early investor support for an annual frequency. As of June 30, approximately 53.6 percent of companies had recommended for annual votes, with 41.4 percent endorsing triennial votes. Recommendations for biennial votes decreased throughout proxy season, stabilizing at

around 2.5 percent. Another 2.6 percent of companies made no recommendation.

However, management preferences did not have a great influence on the outcome of these frequency votes. As of June 30, investors had defied management recommendations for triennial votes at 564 of 978 companies, according to ISS data. Shareholders also were not swayed by biennial recommendations at 43 out of 59 issuers.

While most U.S. companies have said they would heed shareholders' views on the frequency of future "say on pay" votes, there are a few exceptions. Annaly Capital Management and American Reographics both have said they will hold triennial votes, even though investors gave majority support for annual votes.

Golden Parachute Votes

The Dodd-Frank Act also requires companies to hold separate shareholder votes on "golden parachute" arrangements when they seek approval for mergers, sales, and other transactions. However, the SEC rules on this mandate did not take effect until April 25, so few companies held parachute votes this season.

As of July 21, six Russell 3000 companies had conducted golden parachute votes, and five received more than 89 percent support. The exception was SAVVIS, where the sale of the company to CenturyLink earned nearly unanimous investor approval, but the severance arrangements received just 70 percent support. It appears that SAVVIS investors had concerns over \$3.9 million in potential tax gross-up payments for CEO James Ousley. However, the other vote results suggest that investors will tend to support a company's golden parachute payments if they believe that the overall transaction has merit. Six more severance votes are scheduled for the next two months.

Impact of 'Say on Pay'

While some activist investors and news organizations have expressed disappointment that there

weren't a greater number of failed votes this year, most investors have said that the Dodd-Frank-mandated advisory votes had a positive impact by encouraging greater engagement and prodding firms to improve their pay practices.

"These provisions are forcing many companies to reconsider their executive pay policies and ratchet back some of the most abusive practices, such as tax gross-ups and lavish severance packages," said Ann Yerger, executive director of the Council of Institutional Investors.

A number of companies made late changes to their compensation programs or filed additional proxy materials to win shareholder support, including Walt Disney Co., General Electric, Alcoa, Collective Brands, and Assured Guaranty Ltd. At least 50 issuers have made additional filings to address investor concerns and proxy advisers' recommendations. In most cases, the companies objected to the industry peer groups and option-valuation methods used by the proxy advisers.

In a June 10 speech to the Social Investment Forum, SEC Commissioner Luis Aguilar observed that advisory votes appear to be facilitating an increase in communication between issuers and shareholders, and have resulted in positive changes to many companies' executive pay practices.

"Many companies are putting in more performance-based compensation 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," said Aguilar, who also mentioned the positive changes by General Electric.

"There seems to be real evidence that say-on-pay is one catalyst to increasing shareholder engagement more broadly," Aguilar said.

A Look Ahead to 2012

As investors prepare for a second year of market-wide advisory votes, many of them will be looking to see how companies respond to failed votes and significant dissent. While investors will have different thresholds for which firms they will scrutinize more closely, it appears likely that issuers with greater than 30 percent opposition this year will receive greater attention in 2012. According to ISS data, 168 companies, or about 6 percent of the total, received more than 30 percent dissent this proxy season.

Shareholders will be looking to see if these companies make meaningful changes to address the linkage between pay and performance and other compensation concerns. If improvements are significant, investors likely will respond favorably. Two companies that suffered failed "say on pay" votes in 2010--Occidental Petroleum and Key-Corp--made substantive changes to their pay practices and earned 91.3 and 86.7 percent support, respectively, this year. Occidental, for example, cut the CEO's long-term incentive opportunities by 70 percent, expanded the peer group used to benchmark pay, and reduced award opportunities for other named executives.

So far, at least two companies with failed 2011 votes have acted to address investor concerns. Helix Energy Solutions has said it would add performance metrics to its 2011 cash bonus program, while Umpqua Holdings has added performance conditions to previously awarded restricted stock and stock options.

If other companies don't adequately respond to this year's "say on pay" votes, investors may ramp up their protests and withhold support from more compensation committee members in 2012 and vote no during the advisory vote.

Fewer Governance Proposals Filed This Proxy Season

The overall volume of governance proposals was down this season again and hit a new post-Enron low. For meetings held from Jan. 1 to June 30, investors filed 466 governance proposals, down from 615 during the same period in 2010, and 675 in 2009.

The main reason for this drop was the absence of shareholder “say on pay” proposals, which accounted for 77 filings in 2010, and became unnecessary after the passage of the Dodd-Frank Act. The greater workload associated with marketwide advisory votes may have deterred some activists from filing more proposals.

Of the governance proposals filed this season, 259 went to a vote, while 104 were omitted, and 103 were withdrawn. The omission percentage was almost 22 percent, up from 15.6 percent in 2010 and 11 percent in 2009. One explanation is companies were able to exclude 35 proposals this year by offering their own management proposal or taking board action, but many companies did not go as far as activists wanted.

So far, 90 governance proposals have received more than 50 percent of votes cast, down from 116 in 2010, and 149 in 2009. This downward trend is not surprising, given the declining volume of proposals.

Greater Support for Declassification

Among governance proposals, the biggest story during the 2011 spring proxy season was the greater support for shareholder proposals seeking board declassification. While this shareholder campaign didn't get much media attention before season, a diverse group of activists, including Florida's pension system, the Nathan Cummings Foundation, Harvard Law Professor Lucian Bebchuk, and retail investors have been pressing companies to drop staggered board terms and hold annual elections for all directors.

These resolutions averaged 73.5 percent support (based on votes cast “for” and “against”), up more than 12 percentage points from 2010, according to ISS data. (Please see Figure 2). In addition, declassification proposals won majority support at 35 firms.

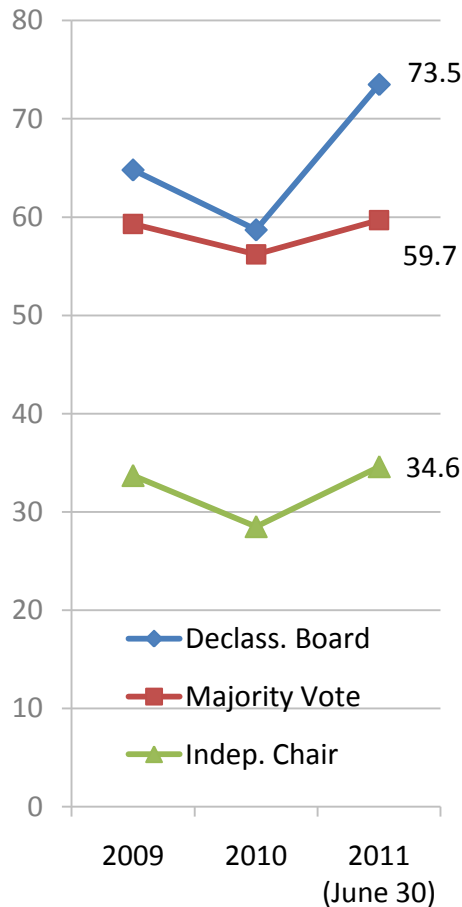
One explanation for the surge in support this year was that activists primarily targeted large-cap firms, which generally have greater institutional share ownership. Of the 38 companies where declassification proposals went to a vote this season, 23 were S&P 500 firms, and these resolutions won majority support at all but one large-cap company. The exception was Reynolds American, which has a 42 percent shareholder that votes with management. In 2010, only 10 of the 46 declassification proposals on the ballot were submitted at large-cap issuers, and 22 were filed at small firms outside the S&P 1500.

Another explanation is that more institutional investors have focused on this issue this year after a trio of recent Delaware court decisions upheld poison pills at companies with classified boards. After these unsuccessful challenges to pills, Bebchuk **argued** in a blog posting that declassification is an “antidote” to a poison pill, observing that such a defense “is powerful only as long as the directors supporting it remain in place.”

As one would expect, declassification proposals have done very well at companies where management was neutral or made no recommendation, winning 97.6 percent support at Juniper Networks, 94 percent approval at St. Jude Medical, and 76.1 percent at Charles Schwab.

“We've been very pleased with the level of investor support for each of our proposals. The results thus far signal a clear investor preference for annual elections and moves to de-stagger boards. For several meetings this year, support levels have surpassed a supermajority,” said Michael P. McCauley, senior officer for investment programs and governance at the Florida State Board of Administration.

Figure 2: Board Issue Proposals
Average support (% cast for/against)



Investors also have negotiated withdrawal agreements on declassification at a much higher rate than in past seasons. At least 15 companies have agreed to put the issue on the ballot this year or in 2012. This year, management proposals have passed at 44 of 47 firms. The exceptions were Eli Lilly, Principal Financial, and Barnes Group, which all have supermajority requirements. At Barnes, management recommended against its own proposal, which was put on the ballot after a shareholder resolution on this topic received 66.9 percent support in 2010. Despite management's opposition, this year's proposal still received 73 percent of votes cast, but failed to receive the neces-

sary approval from two-thirds of the company's outstanding shares.

This season's vote results and proposal withdrawals are further evidence of the waning acceptance of classified boards at large companies. As recently as 2005, a majority (53 percent) of the S&P 500 index had staggered board terms. Today, just 31 percent of large-cap firms maintain classified boards, and another 3.4 percent are in the process of declassifying, according to ISS data.

While classified boards are more common at smaller companies, there has been a similar downward trend. In 2005, 59 percent of S&P 1500 firms had staggered board terms. Today, just 43.6 percent of those companies do, and another 3 percent are in the process of moving toward annual elections for all directors.

However, a few companies have used new state laws to resist shareholder demands for destaggering their board terms. Indiana and Oklahoma both have passed laws that mandate classified boards. Oklahoma's 2010 law mandates classified boards until 2015. Indiana's 2009 law permitted companies to opt out during a limited period, and several companies have opted out retroactively. Ball Corp. used this law to exclude a declassification proposal last season, so shareholders tried a new strategy this year—filing proposals that ask Indiana companies to reincorporate to Delaware. This resolution won 43 percent support at Ball, a solid showing for a new proposal.

Oklahoma-based Chesapeake Energy, which failed to implement a declassification proposal that received 86.7 percent support in 2009 and was featured in a recent *Wall Street Journal* article on Oklahoma's new law, may face a reincorporation proposal in the future.

It remains to be seen whether declassification proposals can repeat this strong showing in 2012. With fewer large-cap firms maintaining staggered board terms, there will be fewer corporate targets with significant institutional ownership where large majorities for declassification would be possible.

Renewed Interest in Majority Voting

After Congress removed a majority voting listing requirement from the Dodd-Frank legislation last summer, activists stepped up their efforts and submitted almost 80 resolutions--the most on any topic this year. After more than two dozen withdrawals, these resolutions went to a vote at 36 companies, and averaged 59.7 percent approval, up from 56.2 percent support in 2010, and 59.3 percent approval in 2009.

Majority voting proposals earned more than 50 percent of votes cast at 22 companies, which included eight S&P 500 firms. Among the highest votes were 99.6 percent at Spark Networks, 87.4 percent at Lorillard, and 82 percent at Gentex; management was neutral at all three companies. There also was 89.7 percent support at Wilshire Bancorp, where management endorsed the proposal. Notwithstanding management opposition, majority voting also received 79.4 percent at Vornado Realty and 77.5 percent at Pioneer Natural.

In addition, the United Brotherhood of Carpenters and other investors withdrew at least 35 proposals, usually after companies agreed to adopt this reform, while Florida and California's pension systems obtained additional commitments through letter-writing campaigns. The Council of Institutional Investors also has urged companies to adopt majority voting. In addition, 16 management proposals on majority voting have won investor approval this year, and it appears likely that investors may see more management proposals on this topic in 2012, especially at small-cap firms.

Improvement for Independent Board Chair Proposals

In a surprising showing, independent board chair proposals averaged 34.7 percent support at 23 companies, an improvement over last year's 28.5 percent showing and better than the 33.7 percent average in 2009, the previous high water mark for this topic. However, this year's average was boosted by an 81.1 percent vote at Cedar Fair L.P.

(which is outside the Russell 3000) during a proxy fight; without this result, this season's average would have been 32.6 percent. This year's rebound may be a result of more selective targeting by proponents; in 2010, 59 proposals were filed and 41 went to a vote.

In addition to Cedar Fair, independent chair proposals won majority support (based on votes cast) this season at Aetna, Moody's, and Vornado Realty after similar proposals fell short in the past.

At Aetna, there was 51.4 percent support this year, as compared with 33.5 percent approval in 2009 and 29.8 percent in 2008. It appears that the health insurance company's financial performance helped persuade investors to embrace this change. The company's one- and three-year total share returns (TSR) of negative 3.62 percent and minus 19.03 percent, respectively, underperformed its industry peers' TSRs of 12.64 percent and negative 0.59 percent, respectively. The company has a presiding director, who does not have the authority to call meetings of independent directors.

At Moody's, there was 56.6 percent support this year, a significant increase from the 33.1 and 30.2 percent votes for independent chair proposals in 2010 and 2009. It appears that this year's vote was a reaction to the rating company's lagging share performance, which has trailed its peers over the past one, three, and five years.

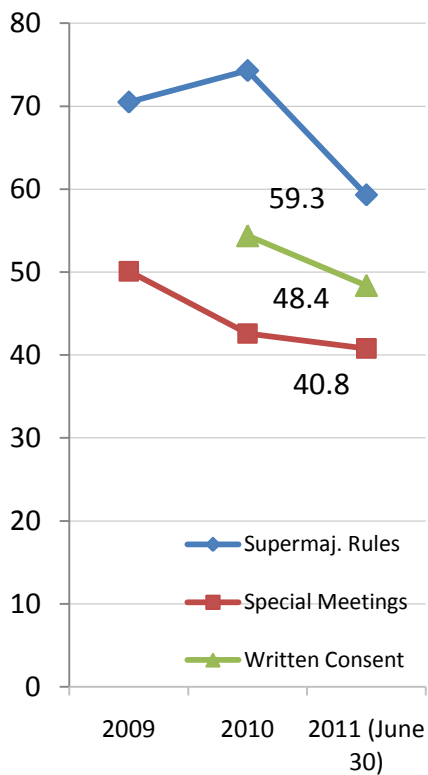
At Vornado, there was 50.7 percent support, up from 41 percent in 2010. While the real estate investment company has posted good performance, management had failed to implement two majority-supported shareholder proposals from 2010.

Cumulative voting proposals, which primarily have been filed by investor activist Evelyn Y. Davis, averaged 30.3 percent approval at 22 companies, up from 27.2 percent in 2010. The best showing for this topic was 41.5 percent support at Home Depot.

CEO succession planning received a significant amount of press attention before this proxy season after the sudden ouster of Hewlett-Packard's

chief executive in August 2010 and the continuing health problems of Apple founder Steve Jobs. The Laborers' International Union of North America planned to file almost a dozen proposals, but withdrew most of them or reached settlements before filing. Just two resolutions went to a vote, receiving 30.1 percent support at Apple and 23.9 percent at Kohl's.

Figure 3: Takeover Defense Proposals
Average Support
(% votes cast for/against)



Less Shareholder Support For Takeover Defense Limits

One surprise this season is that there were fewer proposals to repeal supermajority voting requirements, and these resolutions did not match their season-leading support levels of 2010. These resolutions averaged 59.3 percent support at 15

companies, down from 74.3 percent at 29 companies in all of 2010. (Please see Figure 3). One explanation for the smaller volume of investor proposals this season was that companies were able to omit 16 proposals; in most cases, issuers offered their management proposals on this topic.

This season's results include a 98 percent vote at Prudential Financial, where management supported the proposal, and 78.3 percent at Sprint Nextel. There was just 9.8 percent support at Google, where insiders have a 58 percent voting stake, and other investors presumably concluded that existing supermajority rules help protect their interests. At Southwest Airlines, a proposal filed by shareholder activist John Chevedden won 65.3 percent support, but the company asserted that this resolution was not properly presented for a vote.

While there were fewer shareholder proposals seeking to repeal supermajority provisions, there was a spike in management proposals on this topic. As of June 30, 61 management proposals had gone to a vote, up from 41 during the same period last year. All but seven of this year's proposals have passed. Most of the failures were at companies, such as Eli Lilly, that have an 80 percent of shares outstanding vote requirement. Overall, the prevalence of supermajority rules at large cap firms has been declining. Just 35.5 percent of large-cap firms now have supermajority requirements for a merger or business combination, while 53.4 percent require such approval for by-law or charter amendments, according to ISS GRID data.

Also this year, investors filed 50 proposals that seek the right of investor groups to call special meetings; most proposals called for a 10 percent ownership threshold. Companies were able to omit 12 proposals; in most cases, management offered competing proposals with higher (such as 25 percent) thresholds. Thirty-two shareholder proposals went to vote and averaged 40.8 percent approval, which is slightly below their 2010 showing. Five 2011 proposals won a majority of votes cast; among them were resolutions at NYSE Euronext, NV Energy, and Home Depot. This topic generally received less support at companies, such as

Amazon.com, DuPont, and Office Depot, that already permit shareholders to call special meetings, but have set a higher ownership threshold than sought by activists.

Investors also approved 21 management proposals on this topic and 18 resolutions earned more than 87 percent support. However, there was just 64 percent approval at Mattel; its proposal included a 15 percent net-long position requirement, which some investors viewed as too onerous.

Shareholder proposals seeking the right to act by written consent did not do as well this season as last year when this topic reappeared on proxy ballots after more than a decade absence. Written consent proposals averaged 48.4 percent approval at 32 companies, down 6 percentage points from 2010. This topic received majority support at 12 companies; there was at least 60 percent approval at Devon Energy, Staples, Liz Claiborne Inc., NYSE Euronext, and R.R. Donnelley & Sons. The lowest result was 23 percent support at Kohl's, which has a full array of other shareholder rights, including majority voting, a declassified board, and 10 percent special meeting threshold.

Fewer Compensation Proposals

There were far fewer compensation-related resolutions this year, primarily because of the absence of shareholder "say on pay" proposals. During the spring proxy season, just 32 compensation-related resolutions went to a vote, down from 86 during the first half of 2010. With the arrival of market-wide advisory votes, proponents focused on secondary compensation issues this year, such as the vesting of stock options and performance-based stock.

Proposals seeking shareholder approval of future golden parachute payments averaged 45 percent support at four companies and won majority approval at Lowe's Companies and Whirlpool. While the Dodd-Frank Act allows companies to include severance benefits in their "say on pay" votes, the SEC ruled--in a no-action challenge by Navistar--

that the law doesn't preclude proposals that seek investor approval of future arrangements.

Also winning broad support this season were the Amalgamated Bank's proposals that seek to prohibit the accelerated vesting of stock options. Those proposals averaged 41.5 percent approval and received 45.2 percent support at Sunoco. Resolutions seeking performance-based stock earned almost 35 percent support at four companies; the best showing was 42.6 percent approval at Walgreen.

Retail investor Gerald Armstrong filed a new proposal this year that seeks a shareholder vote on director pay, which is not covered by the Dodd-Frank Act's votes on executive pay. This proposal had single-digit support at three companies, but won an impressive 46.4 percent approval at Chesapeake Energy, where directors receive the rare perk of personal usage of the company aircraft.

At Bank of America's meeting, investors gave 35 percent support to a new shareholder proposal that seeks to ban reimbursement for relocating executives who lose money on the sale of their homes.

A new shareholder proposal that seeks to link executive pay to sustainability metrics did not fare well this year, averaging 5 percent support at four companies.

A Look Ahead to 2012

It appears likely that investors again will file board declassification and majority voting proposals in large numbers next season and continue their letter-writing campaigns. However, as more large-cap issuers agree to these reforms, shareholders likely will turn their focus to mid-cap companies.

In an effort to promote majority voting, the United Brotherhood of Carpenters has petitioned the SEC to eliminate "withhold" votes, which would leave plurality-vote companies with no mechanism for investors to express opposition other than abstentions. The Carpenters hope that such an action by

the SEC would prod thousands of small and mid-cap firms to adopt majority voting.

One key question for 2012 is how shareholders will respond to the July 22 U.S. appeals court ruling that struck down the SEC's controversial proxy access rule.

The appeals court's action means that SEC Rule 14a-11 won't be in place for the 2012 proxy season. The unavailability of a marketwide access regime could mean a rise in traditional boardroom challenges via proxy fights and a jump in "vote no" campaigns against directors.

In the meantime, it appears that investors may be able to take advantage of the SEC's amendments to Rule 14a-8, which were not challenged by business groups, and file access bylaw proposals next season. The SEC had issued a stay on the Rule 14a-8 changes after the lawsuit was filed, but that may be lifted before the filing deadlines for most 2012 meetings. Shareholder activists are discussing now whether it makes sense to file access proposals next season and how many companies to target. It appears likely that any investor resolutions would seek more permissive standards than Rule 14a-11's requirement to hold a 3 percent stake for at least three years.

Editor's Note: Unless otherwise stated, the vote results for the shareholder proposals mentioned in this report are based on the votes cast "for" and "against" and don't include abstentions or broker votes. This method of reporting votes is consistent with SEC Rule 14a-8(i)(12). Many companies use different methods for reporting vote results.

More Investor Support For E&S Proposals

The average investor support for shareholder resolutions on environmental and social (E&S) issues continues to rise.

During the spring proxy season, there was a 20.6 percent average approval rate (as of June 30) for

these proposals, the first time this support level had reached the 20 percent mark. This average compares with 19.3 percent at the same time a year ago and 18.1 for all of 2010, according to ISS data. By contrast, the average support for E&S proposals was just 8.7 percent a decade ago.

This year's vote average includes five investor proposals that received majority support (based on "for" and "against" votes), a new record for E&S issues. These proposals include:

- KBR: a request to include sexual orientation in the company's nondiscrimination policy (61.7 percent approval);
- Tesoro: a request for a report on refinery safety (54.3 percent support);
- Sprint Nextel: a request for a report on political contributions (53.3 percent);
- Ameren: a request for a report on coal combustion waste (52.7 percent); and
- Layne Christensen: management supported a shareholder's request for a sustainability report (92.8 percent).

Additionally, a proposal at Energen requesting a report on the environmental impacts of the hydraulic fracturing method increasingly used in natural gas production won 49.5 percent approval, barely missing receiving majority support, while three proposals requesting a report on political contributions (at Halliburton, R.R. Donnelley, and Lorillard) earned more than 45 percent support.

Political Contributions

As in recent years, political contribution-related proposals accounted for just under a quarter of the proposals filed, and just under a third of the resolutions voted on. What was notable this year was the much greater variety of approaches to this issue following the U.S. Supreme Court's *Citizens United* (2010) decision, which removed caps on

independent corporate spending in federal elections.

As in earlier proxy seasons, though, the largest part of the political contributions campaign were the resolutions from a seven-year-old effort coordinated by the Center for Political Accountability (CPA), which ask for reports on corporate political spending and policies, including spending funneled through trade associations. Thirty-two resolutions in the CPA campaign came to votes this year.

This year, the average support for political contributions proposals was 32.5 percent, up from 30.4 percent for similar proposals in 2010. This average doesn't include a low vote of 5 percent at Sears, which is a controlled company, proposals from several long-running initiatives by activist investor Evelyn Y. Davis, which are different in scope, and a proposal at Home Depot asking for an annual advisory vote on "corporate electioneering."

Among the new variations in proposals were the resolutions coordinated by Walden Asset Management that were directed at companies that serve on the board of the U.S. Chamber of Commerce. In addition to requesting reports on political spending, those proposals asked the companies to discuss the risks and responsibilities associated with serving on boards of and paying dues to trade organizations when positions of the association contradict the company's own positions. The proponents were particularly concerned about the U.S. Chamber's opposition to legislation to mitigate climate change. The resolution was initially filed at seven companies, but after a mix of withdrawals and technical issues, it came to votes only at IBM and PepsiCo, receiving 31.4 and 11 percent support, respectively. In addition to these proposals, Walden also raised the issue from the floor at several other annual meetings this year and plans to continue pressing this matter in 2012.

Other proposals targeted corporate support for ballot initiatives during the 2010 elections. A proposal asking for a report on political contributions in light of the reputational risks arising from cor-

porate contributions given to a group that supported an openly antigay gubernatorial candidate in Minnesota was filed at Best Buy, Pentair, Target, and 3M. Withdrawal agreements were reached at all but 3M, where the proposal received 35.8 percent support. Another proposal voted on at Occidental Petroleum and Valero focused on the companies' corporate support for Proposition 23, the campaign in California that would have suspended a state law to regulate carbon emissions. These proposals earned 30.6 and 34.8 percent support, respectively.

By contrast, a new proposal at Home Depot from NorthStar Asset Management that sought an annual shareholder vote to ratify political expenditures anticipated in the next fiscal year received only 5 percent support. The CPA has specifically opposed that approach.

In addition to the standard CPA proposal, AFSCME filed a new proposal that requested a report on "grassroots lobbying" and corporate funds given to trade associations and other third parties that are used for political purposes. These proposals averaged 24.2 percent support at five companies (the average was lowered by the 8 percent vote at Prudential Financial, the only vote below 25 percent).

Environmental Issues

Environmental proposals were about as prominent during this year's E&S proxy season as political contribution resolutions and even more varied.

The most eye-catching results involved the second year of a campaign coordinated by the Investors Environmental Health Network to ask companies to report on the implications of their use of hydraulic fracturing to tap natural gas reserves. These proposals went to a vote at five companies--Energen, Chevron, ExxonMobil, Ultra Petroleum, and Carrizo Oil & Gas--and averaged 40.7 percent support, up more than 10 points from 2010. The votes came in the wake of increasing regulatory and public attention to an issue many investors were barely familiar with 18 months ago.

Another notable aspect of this proxy season was the increased shareholder attention to the risks related to the use of coal, which is now going beyond concerns about climate change. Activists filed a new resolution asking utilities to report on the financial risks of coal reliance, which ultimately came to votes at four companies. Only one of those resolutions got better than 10 percent support—a 31.4 percent vote at FirstEnergy—as investors appeared to conclude that some of the targets were already implementing this resolution by providing considerable information on the issue, even if the underlying concern remained. In a related campaign, three resolutions that asked utilities to disclose more about how they are approaching the issue of coal combustion waste fared better, winning majority support at Ameren.

Additionally, the Sierra Club filed a new resolution at Dominion Resources asking for a report on mountain-top coal mining that received 9.3 percent support.

The number of resolutions specifically focusing on climate change appears to have fallen this year, from 41 filed in all of 2010 to 34 filed so far in 2011. After many withdrawal agreements, 12 had come to votes by June 30, down from 19 voted on in all of 2010. Eight of those were part of the now familiar campaign requesting companies to adopt quantifiable metrics for greenhouse gas (GHG) emissions. Those votes averaged 18.6 percent support. Among the other climate change proposals that came to votes were second-year resolutions asking for reports from Chevron and ConocoPhillips on the financial risks of climate change; those votes remained low, at under 8 percent. Overall, climate change-related proposals averaged 17 percent support—as compared with 21.1 percent in all of 2010—and it is unlikely that any of the 2011 climate change-related measures listed above will reach the levels seen in 2010.

In addition to the 11 proposals voted on from climate change activists, shareholders considered four from pro-business groups that are skeptical about the severity of the issue. These resolutions averaged only 3.2 percent approval; the best showing was 6.5 percent support for a resolution on climate-related lobbying at Duke Power.

Among other environmental issues, support for resolutions asking companies to report on oil sands development remained strong at ConocoPhillips and ExxonMobil, averaging 27.5 percent.

Sustainability Questions

The number of resolutions proposed requesting reports on sustainability has fallen by about half, to 22, so far in 2011 compared to end of year 2010 figures and a large batch of withdrawals left only seven to go to a vote. These proposals averaged a solid 29.4 percent approval rate, not including the management supported proposal at Layne Christensen, which received 92.8 percent support. However, a new proposal from the Laborers' International Union asking companies to link sustainability metrics to executive compensation got off to a slow start. Of the four proposals that came to votes, the best showing was 6.9 percent support at Sempra Energy. Additionally, the boards at two of the targets, Chevron and Equity Residential, argued in their proxy statements that they had already recently tied their compensation to sustainability.

Sexual Orientation Nondiscrimination

The campaign to get companies to amend their nondiscrimination statements to include sexual orientation and gender identity continued at about the same pace as in recent years (28 proposals filed), as always with a high number of withdrawals. For the nine resolutions that came to votes, the average support was 30.2 percent, three points below the average support in 2009 and 2010, despite this year's 61.7 percent vote at KBR, the highest ever social issues vote result.

Health and Safety Proposals

A new AFL-CIO campaign this year asking oil companies to report on their actions to reduce the risk of workplace accidents received varied levels of support. At Tesoro, where a recent refinery accident had resulted in fatalities, and Valero, where disclosure was limited, the proposals received

54.3 and 43.3 percent approval, respectively. At Conoco and Marathon, the proposals received much lower support of 7.8 and 7.4 percent, respectively. At Chevron, an individual investor filed a proposal that asked for a report on offshore oil wells and safety measures; this resolution received 8.6 percent support.

Recycling

So far this year, investors have voted on three proposals that deal with different aspects of corporate recycling. A repeat proposal at Starbucks, which asked for beverage container recycling goals and a report, received 8.1 percent support. A new proposal at McDonald's--asking for a report on beverage container recycling and information on the company's use of polystyrene beverage containers--received 29.3 percent support. Another new proposal was filed at Target; this proposal asked for a report on minimizing the environmental impact of electronics recycling and earned 30.8 percent support. Proponents affiliated with the As You Sow foundation have promised several more recycling resolutions in the fall proxy season; proposals are pending at Procter & Gamble and General Mills.

Several issues received notably low votes this spring. A revived church-led campaign to get four drug companies to implement a pharmaceutical price restraint policy averaged only 3.2 percent support. Animal welfare-related proposals continue to draw limited support, with just 4.8 percent average approval, as did resolutions on tobacco issues, which averaged 2.4 percent support.

Comparisons With 2010

So far, ISS has tracked 346 E&S proposals proposed for 2011 meetings, and while a few more will undoubtedly surface, it is unlikely that the totals will hit the 384 filed in all of 2010. At 119, the number of negotiated withdrawal agreements is also well below the record of 146 set in 2010. However, the SEC has allowed companies to omit 51 resolutions so far, which already has surpassed last year's total of 50.

Advisory Votes Lead To Less Dissent on Directors

With the Dodd-Frank Act mandating advisory votes on compensation at most U.S. companies this year, shareholders were provided with an alternative avenue to express their views on corporate pay programs--instead of withholding support from pay panel members. The advent of "say on pay" has contributed to a significant decline in opposition to directors at U.S. firms in 2011.

Although the vast majority of directors at U.S. companies were elected with more than 90 percent shareholder support, 43 directors failed to win majority support, according to ISS data on meetings through June 30. During the same periods in 2010 and 2009, 87 and 89 directors, respectively, did not earn majority approval. At the same time, the average support for Russell 3000 directors has climbed to 95 percent, up from 94 percent in 2010 and 93 percent in 2009.

This season, poor attendance was among the reasons that contributed to the highest number of failed elections (40 percent) followed by failure to put a poison pill to a shareholder vote (24 percent). Other reasons that helped fuel high shareholder protest votes this year include the failure to act on majority-supported shareholder resolutions and lack of action on investor concerns that resulted in board members drawing majority opposition in previous board elections (14 percent each). Lack of independence on the board and key committees, egregious governance practices, and sitting on too many boards were other reasons that contributed to majority dissent. Firms in the health care sector suffered the greatest number of failed elections, followed by companies in the industrials sector and then those in the financial services, technology, and retail sectors.

According to ISS data, 17 directors received more than 50 percent shareholder disapproval after it was reported that they failed to attend at least 75 percent of board and/or committee meetings. At Taleo, a Delaware-based talent management soft-

ware solutions provider, a director received just 21.4 percent approval, one of the lowest levels of support this year. Director nominees at Brookdale Senior Living and Hersha Hospitality Trust also failed to win majority support; the dissent apparently was based on poor attendance and concerns that the respective directors sat on too many boards. Investors of CoStar Group withheld a majority of votes from a director amid continuing attendance concerns. In 2010, that same nominee garnered only 40.5 percent support.

The lack of responsiveness by boards to majority-supported shareholder proposals continues to trigger high levels of shareholder dissent. All three trustee nominees at Vornado Realty Trust received majority investor opposition after the board failed to implement two majority-backed shareholder proposals to adopt a majority vote standard for the election of trustees and to declassify the board. The trustee nominees at Vornado's 2010 annual meeting also garnered significant opposition after the board failed to act on an earlier shareholder-approved proposal to require a majority voting standard.

Shareholders also opposed the election of two directors at Ferro Corp. after the board failed to amend the company's code of regulations to provide that the company opt out of the Ohio Control Share Acquisitions Act. This amendment was the subject of a shareholder proposal that won majority support at the firm's 2010 annual meeting.

Shareholders have also registered discontent against boards that failed to address underlying reasons behind failed director elections at the prior year's shareholder meeting. At Fred's Inc., two directors failed to gain majority support this year after the board's failure to seek shareholder approval to renew a poison pill and to adopt a majority voting standard for board elections. This unresponsiveness contributed to majority shareholder opposition to all the company's nominees last year.

At Healthcare Services Group, there again was majority opposition to directors over the board's failure to establish a majority independent board.

Directors at both Stewart Information Services and Michael Baker Corp. also received less than a majority of votes cast this year for failing to be responsive to shareholder concerns that led to majority opposition in the preceding year.

There are at least two meetings thus far where director nominees failed to get the assent of investors after the board failed to submit a poison pill to a shareholder vote. The entire nine-member board of IRIS International received majority investor opposition as the company did not submit a pill adopted in 2010 for shareholder ratification at this year's meeting. A director at Hutchinson Technology also received a majority "withhold" vote under similar circumstances.

Significant Withhold Votes

At S&P 500 Firms

While four directors at two S&P 500 firms (Vornado Realty and Nabors Industries) had majority dissent, almost 60 directors at large-cap firms faced more than 30 percent dissent. More than half of these directors who received high opposition votes at S&P 500 companies failed to act on majority-supported shareholder resolutions.

All members of Allstate's 11-member board drew more than 30 percent negative votes after the board failed to implement a majority-supported shareholder proposal to lower the ownership threshold to call a special meeting from 25 to 10 percent. Shareholder proposals seeking a 10 percent threshold have received majority of votes cast for two consecutive years. There was significant opposition to directors despite management's submission of a proposal to allow holders of not less than 20 percent of the company's outstanding shares to call a special meeting. For the same reason, eight of the 13 directors at Marathon Oil garnered less than 65 percent support. While the board has proposed to lower the special meeting threshold from 25 to 20 percent, shareholders did not appear satisfied with that response to their request for a 10 percent threshold.

At Ball Corp., a director nominee received only 64.3 percent support after the board failed to act on a shareholder proposal to submit the company's poison pill to a shareholder vote. The board's failure to opt out of Indiana's classified board provision also appears to be another factor behind this high opposition level. Shareholder proposals to declassify the board have won majority support in 2005, 2006, 2008, and 2009. By not opting out of the Indiana law, the company has, in effect, installed a perpetually classified board.

Corning, Pioneer Natural Resources, Vornado Realty, and FirstEnergy are other firms where investors expressed significant opposition against at least one director nominee for ignoring majority-supported shareholder proposals.

This year's board election at Cablevision Systems was also noteworthy as all five nominees received high levels of opposition. Investor concerns over the company's governance structure, compensation practices, and lack of responsiveness to shareholder views appear to have spurred the protest votes. In 2010, the firm's pay panel members drew majority withhold votes for entering into new employment agreements with modified single-trigger change-in-control provisions and non-performance-based awards.

Shareholders also withheld a high number of votes from all five nominees at Stanley Black & Decker after the board failed to address the underlying issues that triggered a majority of shareholders to withhold support from one director at the last annual meeting. The concerns expressed at last year's meeting included the board's failure to heed a majority-backed shareholder proposal to declassify the board as well as an agreement with the company's executive chairman that contained guaranteed multiyear equity grants.

Director nominees who serve as affiliated outsiders on key board committees also attracted a considerable number of negative votes at Anadarko Petroleum; BB&T; Becton, Dickinson and Co.; C.H. Robinson Worldwide; Franklin Resources; PNC Financial Services Group; and Whole Foods Market.

Poor meeting attendance and directors serving on too many outside boards were other reasons that drew high opposition votes at large-cap firms. Companies in the energy and financial services sector topped the list of S&P 500 companies that had high levels of shareholder opposition to their boards (32 percent) followed by firms in the industrials and technology and media sectors (16 percent).

Resignation Policies

As in past proxy seasons, most of this year's majority-opposed directors serve at smaller companies that don't have majority voting bylaws or resignation policies for board members who fail to win majority support. However, resignation policies were triggered at several companies this season, including IRIS International, where all nine board members failed to earn majority support after adopting a poison pill without shareholder approval. The board members submitted their resignations, but they decided not to accept them and reaffirmed their position that a non-shareholder-approved pill was merited.

A resignation policy also was triggered at HSN against director Gregory Blatt, who is CEO of the company's former parent, IAC/InterActiveCorp.; the opposition apparently reflected concern that he sits on too many boards. While the board rejected Blatt's resignation, HSN said that Blatt would reduce his other board commitments from three to two after IAC acquires another company, according to Bloomberg News.

At Synovus Life Technologies, a former CEO received majority opposition amid concerns that she was not sufficiently independent to serve on key board committees. The board announced that she would step down from these committees after replacements were identified.

Robert Yates, Mason McAllister, Valerie Ho, and Carol Bowie contributed to this report.

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