Skadden

Executive Compensation and Benefits Alert

May 15, 2012

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or your regular Skadden contact.

Stuart N. Alperin
New York
212.735.3920
stuart.alperin@skadden.com

Neil M. Leff
New York
212.735.3269
neil.leff@skadden.com

Regina Olshan
New York
212.735.3963
regina.olshan@skadden.com

Erica Schohn
New York
212.735.2823
erica.schohn@skadden.com

Joseph M. Yaffe
Palo Alto
650.470.4650
joseph.yaffe@skadden.com

Barbara R. Mirza
Los Angeles
213.687.5614
barbara.mirza@skadden.com

Four Times Square
New York, NY 10036
212.735.3000

Additional Updates on the 2012 Proxy Season

This "Say on Pay" update is the third in a series. For our prior say-on-pay alerts, please see "Say on Pay – Early Lessons From the 2012 Proxy Season" (March 28, 2012) and "Continuing Developments in the 2012 Proxy Season" (April 20, 2012).

As we continue to monitor developments in the unfolding 2012 proxy season, key themes are continuing to develop:

What are the overall vote results?

Of the first 602 companies to report the results of say-on-pay proposals, approximately:

- 70 percent have passed with over 90 percent support;
- 21 percent have passed with between 70.1 percent and 90 percent support;
- 7 percent have passed with between 50 percent and 70 percent support;
- 2 percent (11 companies) obtained less than 50 percent support

Thus far, these percentages are not materially different than the full-year results for the 2011 proxy season.

Please note that all percentages in this summary follow the (For/(For + Against + Abstain)) formulation.

What types of factors appear to be causing 2012 say-on-pay proposals to fail?

FirstMerit Corporation's say-on-pay proposal support decreased from 87 percent in 2011 (when it received a "for" recommendation from ISS) to 46 percent in 2012, when it received an "against" recommendation. ISS indicated that it believes there is a pay-for-performance disconnect at FirstMerit due to a misalignment of CEO compensation and total shareholder return (TSR), both relative to peers and on an absolute basis. ISS also indicated concern about changes that had been made to the annual incentive program providing for partial credit where goals were not achieved and adding strategic performance goals and individual performance elements. These changes caused ISS to determine that there was insufficient visibility to explain the CEO's payout at the maximum level when only a few financial metrics had exceeded target. ISS expressed further concern about a grant to the CEO of restricted stock with time-based

vesting at a value equal to two times base salary. Finally, ISS noted that the CEO's 2011 pay was three times higher than the level of the next most highly compensated executive and theorized that this could reflect weak succession planning. FirstMerit filed supplementary proxy materials stating that ISS: emphasized shorter-term corporate performance while disregarding FirstMerit's stronger long-term performance; ignored performance metrics unique to the banking industry while focusing on TSR; included a substantial number of peers with whom FirstMerit does not compete for talent, including regional banks in states ranging from Hawaii to Mississippi (FirstMerit is based in Ohio); and ignored the fact that 30 percent of the CEO's total 2011 compensation consisted of a retirement benefit accrual that will not be realized for several years. FirstMerit also disputed the idea that its proxy disclosure had been in any way insufficient and indicated that its succession process was robust, providing details about that process. The succession issue is one that ISS appears consistently to be raising for companies with a high disparity between CEO pay and the next most highly paid executive, and companies in this position should consider whether it would be appropriate to include discussion of succession program strength in future proxies.

The Ryland Group, Inc.'s say-on-pay proposal support decreased from 62 percent in 2011 (when it received a "for" recommendation from ISS) to 41 percent in 2012, when ISS issued an "against" recommendation. ISS indicated that it viewed Ryland as having a pay-for-performance misalignment due to TSR underperformance during a period of high CEO pay. ISS further noted that the CEO's pay for 2011 was double the peer group median and expressed concern that Ryland does not disclose its peer group benchmarking targets. ISS also noted that both the equity and annual incentive programs use the same metric (adjusted consolidated pretax earnings) and targets, which ISS suggested could result in duplicative payments for the same performance. ISS has raised this concern regarding duplicative measures across plans in other reports. Companies may want to consider revisiting their strategy with respect to their various performance-based plans (annual incentive, long-term incentive and performance-based equity awards) to ensure there is adequate diversity in measures and targets.

What types of factors appear to be causing say-on-pay proposals to receive lower vote percentages in 2012 than they received in 2011?

While the say-on-pay proposal at Motorola Solutions, Inc. passed with 59 percent approval, this was a sharp decrease from the 89 percent approval level achieved in 2011. ISS had issued a "for" recommendation in 2011, but noted in the 2011 report that the 2012 proxy would be carefully analyzed in order to determine whether various equity grants made in January 2011 in connection with the separation of Motorola Inc. were justified. In 2012, ISS issued an "against" recommendation due to its concerns about the fact that CEO compensation was a multiple of four times the ISS peer group and three-and-a-half times Motorola Solutions' peer group, raising pay for performance concerns even in light of strong corporate performance relative to those groups. It also believes that equity grants made in connection with the separation (and as part of a simultaneous renegotiation of the CEO's employment agreement) had a high value ($36 million using ISS estimates), relatively low performance thresholds and overlapping goals, with little explanation for the rationale of making grants of this size. This emphasizes the importance of considering and describing the strategic rationale for grants and compensation decisions made in the context of major corporate events and transitions as well as those made during the normal course of business, and also serves as a reminder that ISS is willing to identify pay-for-performance disconnects even where a company performs well against its peer group, if it views CEO compensation as outpacing that performance.

What factors appear to be causing say-on-pay proposals to receive higher vote percentages in 2012 than they received in 2011?

The say on pay proposal approval percentage at Umpqua Holdings Corporation increased from 35 percent in 2011 to 95 percent in 2012. ISS had issued an "against" recommendation in 2011 due to what it viewed as a pay-for-performance disconnect caused by increases in salary, short-term incentives and long-term incentives when Umpqua's

TSR as compared with its peers was below median. ISS switched its recommendation to "for" in 2012 due to its belief that Umpqua had responded effectively to shareholder concerns and made appropriate changes in its compensation programs. In particular, Umpqua decreased the CEO's salary (by 6.7 percent) and target incentive award, increased performance hurdles and granted performance-based equity awards rather than the time-based equity awards which had been awarded in the past. In essence, Umpqua appears to have responded very specifically to the precise concerns articulated by ISS, and we are observing that this type of targeted responsiveness is well-received by ISS.

Stewart Information Services Corporation reported an increase in the approval given its say-on-pay proposal from 48 percent in 2011 to 97 percent in 2012. In 2011, ISS had recommended "withhold" votes for the entire Board, as well as an "against" vote on the say-on-pay proposal due to a perceived pay-for-performance disconnect and the board's failure to address concerns relating to 2009 compensation that had resulted in majority opposition in 2010 to the re-election of the members of the compensation committee. ISS also expressed concern about Stewart's co-CEO structure due to its potential extra cost to shareholders, and expressed concern that the details and rationale for this arrangement were not adequately explained. In 2012, ISS issued a "for" recommendation based on Stewart's engaging with its shareholders on these issues and making changes including: elimination of the decades-long co-CEO structure; a shift from discretionary to performance-based incentives and benchmarking of compensation at the peer group median; and a strategic and organizational review that led to separation of the CEO and chairman roles, election of a new chair of the compensation committee, and hiring of new human resources and compensation executives as well as a new advisor to the compensation committee. This example is particularly noteworthy for the strategic and governance-based changes (as opposed to solely compensation program revisions) made in response to the 2011 ISS report.

How have companies been responding this year to 'against' recommendations by ISS and other proxy advisors?

Most pre-emptive filings made by companies whose say-on-pay proposals received "against" recommendations addressed what the companies saw as flaws in the ISS methodology, and we have continued to see the themes emphasized in these filings that we previously discussed in our second mailing, "Continuing Developments in the 2012 Proxy Season" (April 20, 2012). Recent additional developments include the following:

- Many companies have continued to express significant concerns regarding ISS's peer group determination methodology, based on the issues described in our last mailing as well as: (a) choosing "peers" based on revenues but ignoring very different levels of profitability; (b) including "peers" that are either too geographically dispersed or, conversely, that do not reflect the company's global reach, resulting in the inclusion of "peers" with which the company in question does not compete for customers, investors or talent; and (c) generating peer groups using a standardized methodology, unlike the company's peer group, which is chosen only after an in-depth analysis and considerable time and effort. Some companies have indicated that the ISS peer group includes only a single company that is truly a peer, while others have noted the different results and recommendations issued by different advisory firms due to their having chosen different peer groups, neither of which match the company's chosen peer group.
- A number of companies also have expressed confusion as to why ISS has indicated concerns in areas (*e.g.* peer group composition) where it did not express concern in 2011, when the underlying facts have not changed. Others have noted that their compensation decisions were made in early 2011 using the then-current ISS methodology (*i.e.*, prior to the newest ISS methodology being released), and that they believe they would have passed the old tests.

- Companies have continued to voice concern regarding TSR being the sole determinant of performance for purposes of determining whether there is a pay-for-performance disconnect, and have noted that while long-term shareholder value is important, other items may be more important in the short term in order to achieve those longer-term TSR results, including quality of assets held (in the case of companies in the financial industry), cost-cutting goals and technology improvements, among others.

As the events of this second say-on-pay season unfold, we will continue to keep you up to date regarding items of interest and developing themes. If you have any questions regarding your proxy disclosure or your executive compensation plans and programs, please do not hesitate to contact us.