

# Shareholder Proposals and Corporate Governance: Proxy Advisory Services

PLI's Preparation of Annual Disclosure Documents 2009  
Chicago, January 12-13, 2009

# Institutional Shareholders, Proxy Advisors and Other Entities

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- ▶ Institutional Shareholders, **Proxy Advisors**, Rating Agencies and Other Entities
  - ▶ Audit Integrity
  - ▶ The Corporate Library
  - ▶ California Public Employees' Retirement System (CalPERS)
  - ▶ Council of Institutional Investors (CII)
  - ▶ Fidelity
  - ▶ **Glass, Lewis & Co.**
  - ▶ GovernanceMetrics International (GMI)
  - ▶ International Corporate Governance Network (ICGN)
  - ▶ **PROXY Governance, Inc.**
  - ▶ **Risk Metrics Group, Inc. (RMG) [*formerly, Institutional Shareholder Services (ISS)*]**
  - ▶ Vanguard Group

## Risk Metrics Group (RMG)

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- ▶ Leading provider of proxy voting and corporate governance data services.
- ▶ RMG provides a ranking system, its Corporate Governance Quotient (CGQ) designed to assist institutional investors in evaluating the quality of corporate boards.
- ▶ Covers 38,000 shareholder meetings across 100 markets.
- ▶ RMG recently announced that it is working on a new CGQ system that it hopes to roll out for the 2010 proxy season

## Risk Metrics Group (RMG) (continued)

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- ▶ The CGQ – RMG evaluates 65 variables in 8 core categories:
  - ▶ Board Structure and Composition
  - ▶ Audit Issues
  - ▶ Charter and Bylaw Provisions
  - ▶ State of Incorporation
  - ▶ Executive and Director Compensation
  - ▶ Qualitative Factors
  - ▶ D&O Stock Ownership
  - ▶ Director Education
- ▶ **CGQ Verification Tool** – permits companies free access to the data RMG has collected to verify it

## Risk Metrics Group (RMG) (continued)

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- ▶ **Examples of Negative Factors in the RMG Rating System**
  - ▶ Board controlled by a majority of insiders and affiliates
  - ▶ Staggered-term Board
  - ▶ No standing Nominating Committee
  - ▶ Compensation Committee includes affiliates
  - ▶ Positions of Chairman and CEO held by same person
  - ▶ No designated lead director
  - ▶ Inability of Shareholders to call a Special Meeting or take action by Written Consent

# RMG's Top Ten CGQ Rankings as of 12/31/08

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## S&P 500

- ▶ Sun Microsystems, Inc.
- ▶ Cardinal Health, Inc.
- ▶ National City Corp.
- ▶ Home Depot, Inc.
- ▶ Big Lots, Inc.
- ▶ Teradyne, Inc.
- ▶ Entergy Corp.
- ▶ Altera Corp.
- ▶ The Walt Disney Company
- ▶ American International Group, Inc.

## Russell 3000

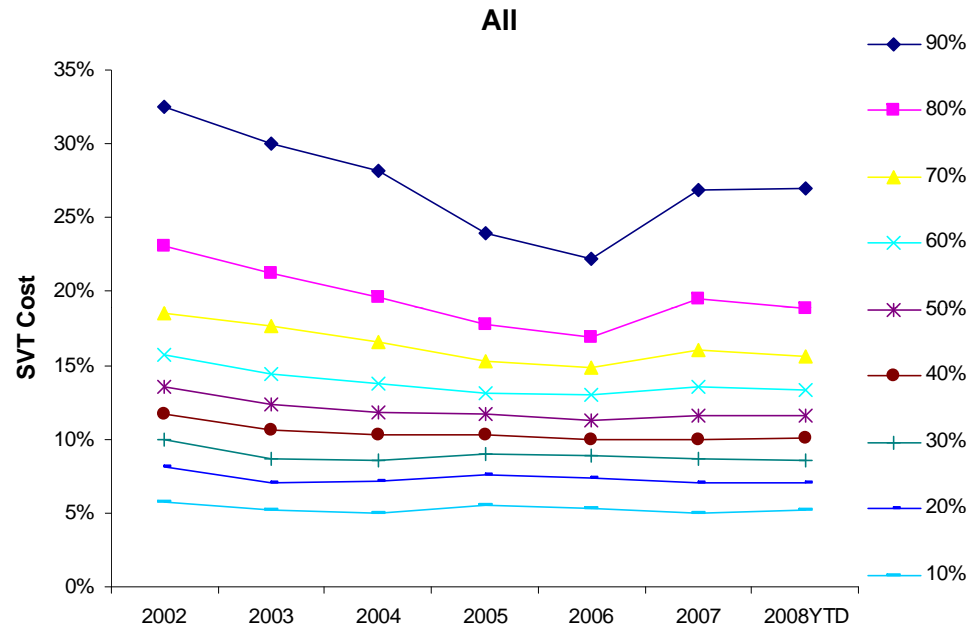
- ▶ Allied Waste Industries, Inc.
- ▶ Hexcel Corp.
- ▶ McGrath RentCorp
- ▶ Radian Group Inc.
- ▶ OceanFirst Financial Corp.
- ▶ Alleghany Corp.
- ▶ West Coast Bancorp (Or)
- ▶ Mirant Corp
- ▶ U-Store-It Trust
- ▶ The St. Joe Company

# RMG's Two Key Quantitative Metrics

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- ▶ In evaluating equity-based compensation plan proposals, RMG relies on two key quantitative metrics, Shareholder Value Transfer and Burn Rate
- ▶ **Shareholder Value Transfer (“SVT”) Analysis**
  - ▶ Determined by a binomial option pricing model – SVT is expressed as a percentage of total market value
  - ▶ Key drivers of SVT are stock price, volatility, dividend yield, types of awards granted, avg. exercise price and remaining term for outstanding awards
  - ▶ Plan cost is deemed reasonable if below company-specific allowable cap
  - ▶ Allowable caps are set based on an industry benchmarking with an adjustment for size and company performance
  - ▶ See RMG Proxy Voting Manual for full details on methodology
- ▶ **Burn Rate Analysis**
  - ▶ Burn rate analysis is based on the average burn rate over the past three fiscal years
  - ▶ Burn rate includes both stock options and “full-value” awards. Full-value awards are counted as more than one share towards the burn rate based on a multiplier
  - ▶ Burn rate is defined as the number of awards granted in a year divided by the weighted average common shares outstanding for that fiscal year.
  - ▶ Burn rates are benchmarked by GICS industry group and segmented between companies in the Russell 3000 and companies outside the Russell 3000
  - ▶ See RMG Proxy Voting Manual for full details on methodology

# SVT costs of all firms analyzed by RMG

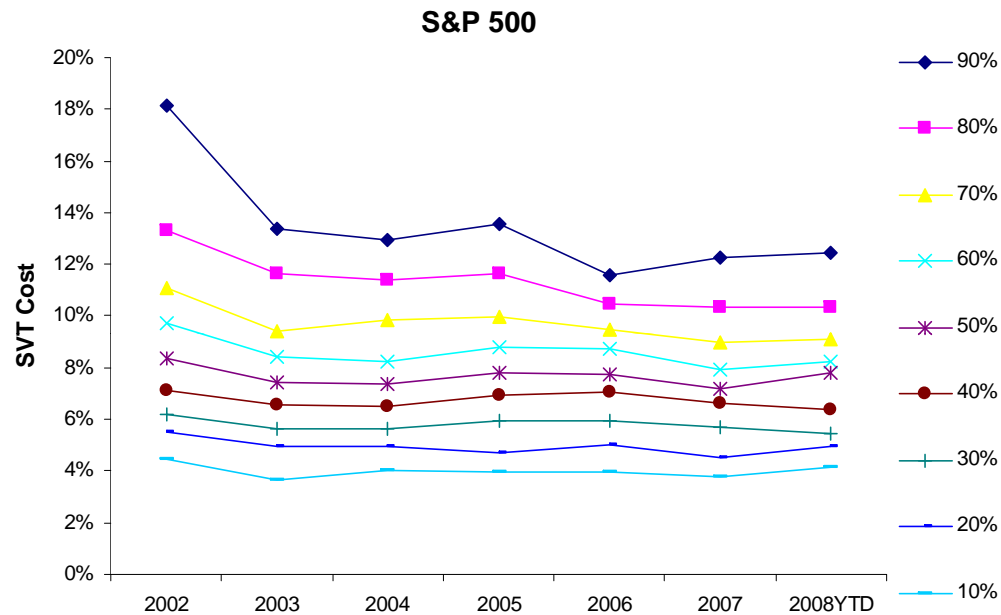


SVT Cost at Each Specific Percentile							
Percentile	2002	2003	2004	2005	2006	2007	2008YTD
90%	32.52%	30.00%	28.15%	23.97%	22.24%	26.90%	27.00%
80%	23.04%	21.23%	19.57%	17.78%	16.85%	19.47%	18.86%
70%	18.51%	17.67%	16.54%	15.26%	14.85%	16.04%	15.63%
60%	15.71%	14.43%	13.73%	13.13%	12.97%	13.57%	13.36%
50%	13.59%	12.31%	11.85%	11.70%	11.22%	11.63%	11.61%
40%	11.66%	10.60%	10.33%	10.32%	9.99%	10.01%	10.05%
30%	9.97%	8.70%	8.57%	8.95%	8.83%	8.69%	8.61%
20%	8.09%	7.05%	7.11%	7.59%	7.34%	7.09%	7.04%
10%	5.77%	5.21%	5.04%	5.55%	5.27%	4.95%	5.20%

This chart shows levels of shareholder value transfer at each decile of proposals reviewed for a given year. A company sample at the X percentile means that X% of all samples for a given year were lower.



# SVT costs of firms in the S&P 500 Index

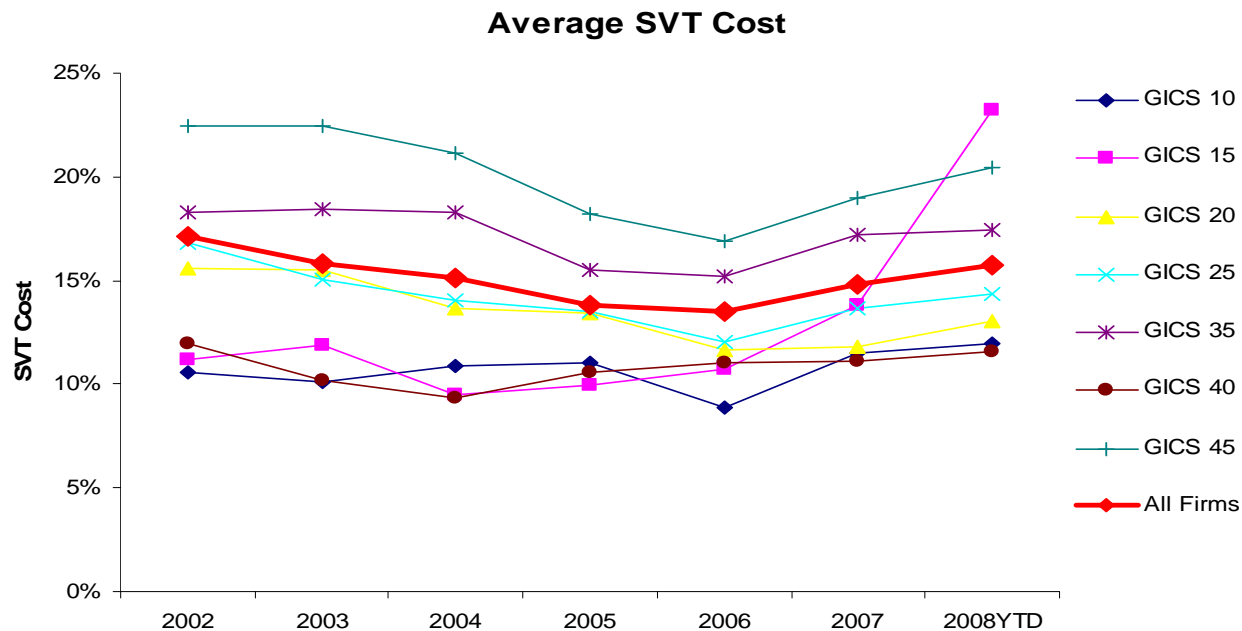


SVT Cost at Each Specific Percentile							
Percentile	2002	2003	2004	2005	2006	2007	2008YTD
90%	18.16%	13.37%	12.91%	13.59%	11.59%	12.27%	12.47%
80%	13.34%	11.66%	11.42%	11.64%	10.48%	10.32%	10.34%
70%	11.10%	9.40%	9.84%	9.97%	9.46%	8.97%	9.12%
60%	9.70%	8.42%	8.21%	8.82%	8.75%	7.90%	8.26%
50%	8.36%	7.41%	7.38%	7.78%	7.77%	7.21%	7.78%
40%	7.11%	6.54%	6.50%	6.94%	7.05%	6.62%	6.36%
30%	6.21%	5.66%	5.62%	5.93%	5.92%	5.67%	5.44%
20%	5.52%	4.98%	4.98%	4.72%	5.03%	4.51%	4.93%
10%	4.46%	3.67%	4.05%	3.93%	3.99%	3.80%	4.13%

This chart shows levels of shareholder value transfer at each decile of proposals reviewed for a given year. A company sample at the X percentile means that X% of all samples for a given year were lower.

# Trends in Average SVT

Industry	GICS	Average SVT Cost						
		2002	2003	2004	2005	2006	2007	2008YTD
Energy-	GICS 10	10.58%	10.11%	10.84%	11.04%	8.84%	11.53%	11.97%
Materials*	GICS 15	11.21%	11.90%	9.51%	9.99%	10.70%	13.83%	23.25%
Industrials	GICS 20	15.62%	15.49%	13.67%	13.41%	11.68%	11.79%	13.07%
Consumer Discretionary	GICS 25	16.82%	15.02%	14.02%	13.53%	12.01%	13.67%	14.37%
Consumer Staples	GICS 30	19.41%	11.61%	13.46%	9.08%	11.64%	13.84%	12.39%
Health Care	GICS 35	18.27%	18.42%	18.25%	15.53%	15.23%	17.22%	17.41%
Financials	GICS 40	11.94%	10.15%	9.33%	10.57%	11.07%	11.10%	11.54%
Information Technology	GICS 45	22.42%	22.47%	21.11%	18.25%	16.86%	18.94%	20.45%
All Firms		17.11%	15.83%	15.11%	13.81%	13.53%	14.81%	15.70%



Source: RMG's Trends in Shareholder Value Transfer and Burn Rates, December 2008

\*Note: The average SVT cost of companies in materials industry (GICS 15) is skewed upward by two compensation proposals – one from Igene Biotechnology, Inc. whose cost is 300 percent, another from Converted Organics Inc. whose cost is 271 percent. Excluding those two cost, the average for this industry was 11.57 percent.

# RMG's 2009 Policy Updates

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## ▶ Compensation Peer Groups

- ▶ For Russell 3000 CEO pay comparisons, peer group parameters:
  - ▶ Company size ranging from 0.5 to 2.0 times the company's size – generally by revenue, will use assets for financial services companies and may use market cap, as appropriate
  - ▶ A minimum of 8 companies
  - ▶ For extremely large companies, we may also use wider industry sectors or a market index to create a peer group of reasonably similar companies
- ▶ **Consequence:** RMG will now use this methodology for determining the peer group for its **CEO pay comparison** at the front of a company's proxy analysis

# RMG's 2009 Policy Updates

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## ▶ Compensation Peer Groups (continued)

### ▶ RMG's 2009 Peer Groups – different groups for:

#### ▶ Display of CEO Pay Relative to Peers

- See prior slide

#### ▶ Performance Test for the Election of Directors

- A company's 4-digit GICS (Russell 3000 companies only)

#### ▶ Independent Chair (Separate Chair/CEO)

- A company's 4-digit GICS (Russell 3000 companies only)

#### ▶ Capital Authorization Requests

- 11 peer groups: Energy, metals & mining; Consumer goods, beverages, agricultural products; Chemicals and pharmaceutical manufacturing; Banking; Financial services, savings institutions, REITs; Technology; Manufacturing; Services; Retail, wholesale; Utilities; IPO

# RMG's 2009 Policy Updates

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- ▶ **Compensation Peer Groups (continued)**
  - ▶ RMG's 2009 Peer Groups – different groups for:
    - ▶ Allowable Cap Calculation under the SVT Test on Equity Plan Evaluations
      - 4-digit GICS group; top quartile performers within group on 3-year TSR; establish normative SVT levels; formulate industry-specific cap equation
    - ▶ Burn Rate Cap Calculations in Equity Plan Evaluations
      - 4-digit GICS
    - ▶ CEO Pay vs. Performance Test in Equity Plan Evaluations
      - 4-digit GICS (Russell 3000 companies only)

# RMG's 2009 Policy Updates

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## ▶ Equity-Based Compensation Plan Policy

- ▶ RMG will recommend **against** an equity plan proposal if any of the following factors apply:
  - ▶ Total **cost** of the plan is **unreasonable** (Cost (SVT) > Allowable Cap)
  - ▶ Plan expressly **permits** the **repricing** of stock options/stock appreciation rights (SARs) without prior shareholder approval (includes cash out of underwater options/SARs)
  - ▶ The CEO is a participant in the proposed plan and there is a **disconnect** between **CEO pay** and the **company's performance** where over 50% of the year-over-year increase is attributed to equity awards
  - ▶ Company's **3-year burn rate** exceeds the **greater of 2%** and the **mean plus one standard deviation** of its industry group
  - ▶ The Plan provides for the **acceleration of vesting** of equity awards even though an **actual change in control may not occur**
  - ▶ The Plan is a **vehicle** for **poor pay practices**

# RMG's 2009 Policy Updates

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## ▶ Poor Pay Practices Policy

### ▶ RMG added the following:

- ▶ Any new or materially amended arrangements that include **tax gross-ups on excise payments** triggered by severance (golden parachute) payments or **modified single-triggers**
- ▶ **Liberal change in control definition** in individual contracts or equity plans which could result in **payments** to executives **without an actual change in control occurring**
- ▶ **Tax gross-ups on executive perks**
- ▶ **Payment** of dividends or dividend equivalents on **unearned performance awards**

### ▶ **Consequence:** If RMG finds a company has Poor Pay Practices:

- ▶ May recommend a **withhold vote** or **against vote** on **compensation committee members, CEO**, and potentially the **entire board**
- ▶ Recommends **against equity plans** if the plan is a **vehicle for poor compensation practices**

# RMG's 2009 Policy Updates

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## ▶ Pay for Performance Policy

- ▶ RMG changed how it evaluates performance, i.e., how it determines if there has been a “performance disconnect:”
  - ▶ Old way: **Absolute Performance** – Looked to see if a company’s own 1- and 3-year total shareholder returns (TSR) were **both negative**
  - ▶ New way: **Relative Performance** – Looks to see if a company’s 1- and 3-year TSR are below its industry (4-digit GICS) group’s 1- and 3-year median TSR
- ▶ If there is a performance disconnect, RMG will then look to see if:
  - ▶ The CEO’s pay **increased** year-over-year, and, if so, whether **over half** of the increase is due to **equity-based** compensation, and
  - ▶ The **CEO** is a **participant** of the equity proposal
- ▶ **Consequence:** RMG will generally recommend **against plans** and/or **withhold votes** from the **compensation committee members**.



# RMG's 2009 Policy Updates

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## ▶ Burn Rate Policy

- ▶ RMG has expanded the stock price volatility measure from 200-day to 400-day for determining the company's 3-year average burn rate
- ▶ Updated its Burn Rate Table for 2009 (next slide)
- ▶ Full Value Multiplier Table for determining burn rates:

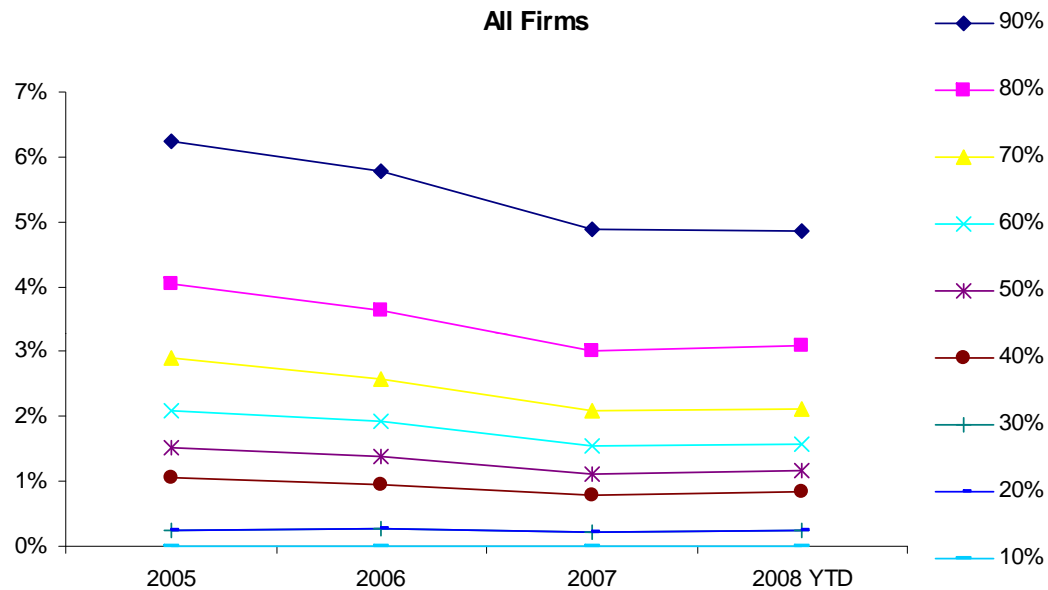
Stock Price Volatility	Multiplier
54.6% and higher	1 full-value award will count as 1.5 option shares
36.1% or higher and less than 54.6%	1 full-value award will count as 2.0 option shares
24.9% or higher and less than 36.1%	1 full-value award will count as 2.5 option shares
16.5% or higher and less than 24.9%	1 full-value award will count as 3.0 option shares
7.9% or higher and less than 16.5%	1 full-value award will count as 3.5 option shares
Less than 7.9%	1 full-value award will count as 4.0 option shares

# RMG's 2009 Policy Updates

## ► 2009 Burn Rate Table

		Russell 3000			Non-Russell 3000		
GICS	Description	Mean	Standard Deviation	Mean+STDEV	Mean	Standard Deviation	Mean+STDEV
1010	Energy	1.75%	1.35%	3.09%	2.41%	2.75%	5.15%
1510	Materials	1.22%	0.91%	2.14%	2.17%	1.63%	3.80%
2010	Capital Goods	1.69%	1.83%	3.52%	2.71%	2.44%	5.15%
2020	Commercial Services & Supplies	2.21%	1.79%	4.01%	2.50%	2.19%	4.69%
2030	Transportation	1.82%	1.36%	3.18%	1.86%	1.59%	3.45%
2510	Automobiles & Components	1.86%	1.19%	3.05%	1.86%	1.19%	3.05%
2520	Consumer Durables & Apparel	2.06%	1.38%	3.44%	2.33%	2.46%	4.79%
2530	Consumer Services	2.11%	1.21%	3.32%	2.75%	2.39%	5.14%
2540	Media	1.87%	1.38%	3.25%	3.16%	2.98%	6.13%
2550	Retailing	1.84%	1.27%	3.12%	2.79%	1.83%	4.62%
3010, 3020, 3030	Consumer Staples	1.77%	1.35%	3.12%	2.39%	2.06%	4.45%
3510	Health Care Equipment & Services	2.72%	1.67%	4.39%	3.63%	3.01%	6.64%
3520	Pharmaceuticals & Biotechnology	3.40%	2.36%	5.76%	4.98%	4.49%	9.46%
4010	Banks	1.20%	0.97%	2.18%	1.40%	1.50%	2.89%
4020	Diversified Financials	2.94%	2.62%	5.56%	5.12%	5.93%	11.05%
4030	Insurance	1.23%	0.98%	2.22%	2.49%	2.22%	4.71%
4040	Real Estate	1.07%	0.99%	2.05%	1.33%	1.52%	2.85%
4510	Software & Services	4.05%	2.72%	6.76%	5.57%	4.56%	10.12%
4520	Technology Hardware & Equipment	3.24%	2.29%	5.52%	3.54%	2.76%	6.30%
4530	Semiconductors & Semiconductor Equipment	3.69%	2.02%	5.72%	4.95%	2.84%	7.79%
5010	Telecommunication Services	2.16%	1.57%	3.74%	2.92%	3.00%	5.92%
5510	Utilities	0.81%	0.83%	1.64%	0.87%	1.00%	1.86%

# Burn Rate of all firms analyzed by RMG



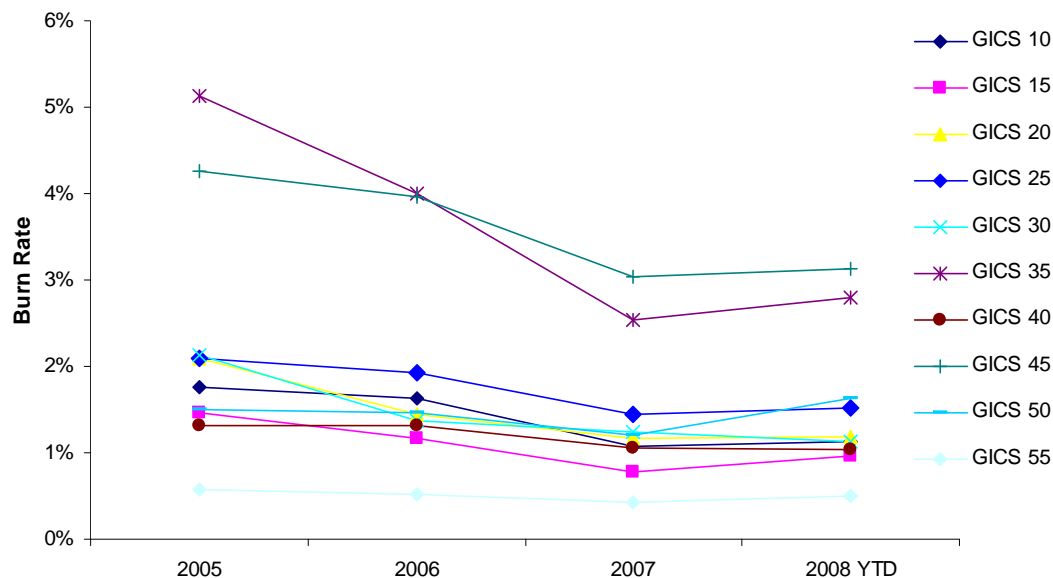
BurnRate at Each Percentile				
PercentRank	2005	2006	2007	2008 YTD
90%	6.25%	5.79%	4.88%	4.86%
80%	4.04%	3.62%	3.01%	3.09%
70%	2.90%	2.59%	2.09%	2.12%
60%	2.08%	1.92%	1.54%	1.57%
50%	1.51%	1.38%	1.12%	1.18%
40%	1.06%	0.96%	0.78%	0.83%
30%	0.65%	0.61%	0.49%	0.54%
20%	0.25%	0.27%	0.21%	0.25%
10%	0.00%	0.00%	0.00%	0.00%

This chart shows levels of 3-year average burn rate at each decile of proposals reviewed for a given year. A company sample at the X percentile means that X% of all samples for a given year were lower.

# Trends in average Burn Rate (Russell 3000)

Industry	GICS	Average Burn Rate (Russell 3000)			
		2005	2006	2007	2008 YTD
Energy	GICS 10	1.76%	1.63%	1.07%	1.12%
Materials	GICS 15	1.46%	1.16%	0.77%	0.96%
Industrials	GICS 20	2.10%	1.45%	1.16%	1.18%
Consumer Discretionary	GICS 25	2.09%	1.93%	1.45%	1.53%
Consumer Staples	GICS 30	2.14%	1.36%	1.24%	1.13%
Health Care	GICS 35	5.13%	4.00%	2.55%	2.79%
Financials	GICS 40	1.32%	1.31%	1.06%	1.04%
Information Technology	GICS 45	4.26%	3.97%	3.04%	3.13%
Telecommunication Services	GICS 50	1.50%	1.46%	1.21%	1.62%
Utilities	GICS 55	0.58%	0.52%	0.43%	0.51%

Average of Burn Rate By Industry (Russell 3000)



# RMG's 2009 Policy Updates

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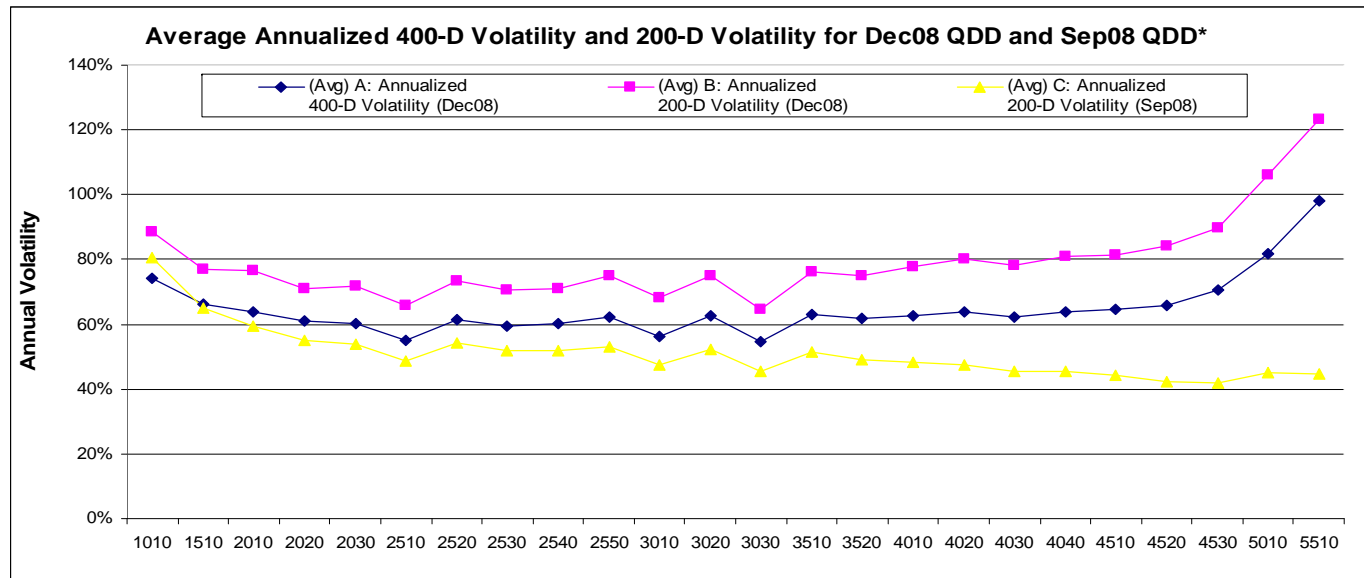
- ▶ **Volatility Assumptions in Equity Plan Proposals**
  - ▶ For the 12/1/08, 3/1/09, 6/1/09 and 9/1/09 quarterly data download dates, RMG will use 400-day volatility for the shareholder value transfer and burn rate policies
  - ▶ RMG intends to revert to the 200-day volatility for the 12/1/09 and subsequent quarterly download dates

## RMG's Response to Stock Market Activity

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- ▶ RMG's policy updates reflect the following changes which were a response to the recent stock market turbulence :
  - ▶ **Volatility** – Switched to using 400-day volatility from 200-day volatility
    - ▶ **Consequence:** Provides a lower volatility figure for most companies, which translates into lower SVT, but higher burn rate
  - ▶ **Stock Price** – Switched to the 3-month average closing stock price from the 200-day average stock price – not part of the updates, announced afterwards on 12/11/08
    - ▶ **Consequence:** Provides a lower stock price for most companies, which translates into lower SVT

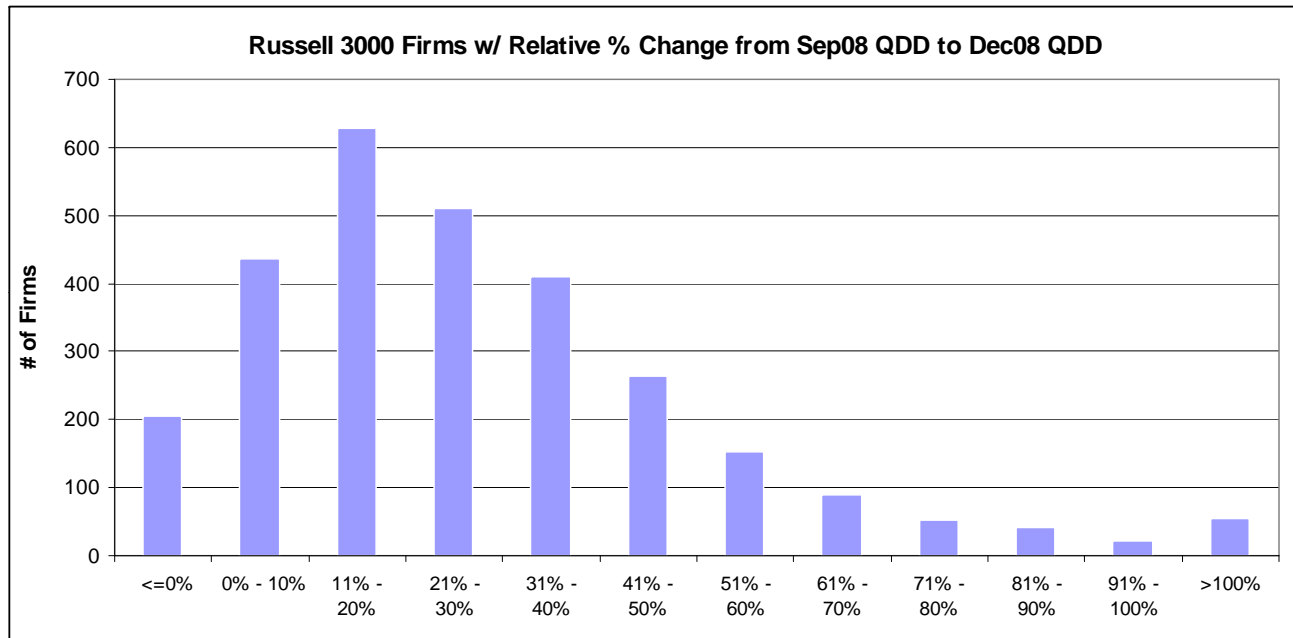
# Using 400-day volatility estimates will significantly reduce volatility for the 12/1 QDD (Russell 3000)



GICS	GICS Desc	(Avg) A: Annualized 400-D Volatility (Dec08)	(Avg) B: Annualized 200-D Volatility (Dec08)	(Avg) C: Annualized 200-D Volatility (Sep08)
1010	Energy	74.16%	88.42%	80.37%
1510	Materials	66.38%	77.17%	65.12%
2010	Capital Goods	63.66%	76.48%	59.60%
2020	Commercial Services & Supplies	60.91%	71.00%	55.22%
2030	Transportation	60.13%	71.87%	53.79%
2510	Automobiles & Components	54.86%	65.64%	48.74%
2520	Consumer Durables & Apparel	61.40%	73.52%	54.08%
2530	Hotels Restaurants & Leisure	59.44%	70.45%	51.68%
2540	Media	60.32%	70.92%	51.92%
2550	Retailing	62.19%	74.80%	52.86%
3010	Food & Staples Retailing	56.21%	68.33%	47.30%
3020	Food Beverage & Tobacco	62.76%	74.88%	52.43%
3030	Household & Personal Products	54.63%	64.69%	45.30%
3510	Health Care Equipment & Services	63.03%	76.01%	51.46%
3520	Pharmaceuticals & Biotechnology	61.71%	75.07%	48.98%
4010	Banks	62.57%	77.73%	48.07%
4020	Diversified Financials	63.89%	79.98%	47.64%
4030	Insurance	62.38%	78.08%	45.63%
4040	Real Estate	63.89%	80.77%	45.63%
4510	Software & Services	64.65%	81.43%	44.36%
4520	Technology Hardware & Equipment	65.95%	84.22%	42.25%
4530	Semiconductors & Semiconductor Equipment	70.62%	89.59%	41.90%
5010	Telecommunication Services	81.69%	106.04%	45.24%
5510	Utilities	98.04%	123.35%	44.70%

\*Note: A is 400-D Volatility for Dec08 QDD  
 B is 200-D Volatility for Dec08 QDD  
 C is 200-D Volatility for Sep08 QDD

# But volatility is still up on average as compared to the 9/1 QDD



Range of Relative % Change	# of Firms w/ Relative % Change from C to A*
<=0%	205
0% - 10%	437
11% - 20%	627
21% - 30%	511
31% - 40%	409
41% - 50%	264
51% - 60%	152
61% - 70%	90
71% - 80%	53
81% - 90%	41
91% - 100%	22
>100%	54

\*Note: A is 400-D Volatility for Dec08 QDD  
C is 200-D Volatility for Sep08 QDD



# Predictions on RMG and Proxy Season

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- ▶ ***Hold on tight, it's going to be a bumpy ride***
- ▶ RMG made numerous significant changes to its policies
- ▶ Some policy changes were made after RMG had issued its 2009 Policy Updates
- ▶ When questioned on numerous points concerning the policy updates, RMG was unable to fully explain how the policy would be applied
- ▶ The revised policies will have a significant impact on the design of equity compensation plans and employment and severance agreements
- ▶ Know the RMG policy changes and how they might impact RMG's proxy analysis for your company
- ▶ Likely to be significant issues with RMG's Research group when it applies these policies – be prepared to review RMG's draft proxy analysis and have a conversation with RMG

# Compensation Plan Approval Process

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## Plan

- Review your institutional shareholders
- Review the significant shareholders' requirements for compensation plans
- Determine plan design and share authorization
- Draft plan document

## Engage

- Draft your plan proposal to address your institutional shareholders' requirements
- Schedule conversations with your significant institutional shareholders to review the proposed plan and address any concerns they have with it

## Vote

- Review the proxy advisors' voting recommendations on the proposed plan
- Monitor the voting on the proposed plan at the annual meeting

# Speaker

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- ▶ Edward Hauder, Exequity LLP
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