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# "Surviving Say-on-Pay: A Roadmap for Winning the Vote in Challenging Situations"

**Tuesday, October 29, 2024**

**Course Materials**

# “Surviving Say-On-Pay: A Roadmap for Winning the Vote in Challenging Situations”

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2 to 3 p.m. Eastern [archive and transcript to follow]

Achieving an acceptable Say-on-Pay vote has become increasingly challenging as more companies are being compelled to develop non-traditional compensation packages in connection with the hiring, retention and termination of executive officers, while proxy advisors and institutional investors continue to demand greater transparency, rigorous goals and strong alignment with company performance. In this session, we provide a roadmap for companies to successfully navigate Say-on-Pay challenges by working through scenarios that companies frequently encounter.

Join our panelists:

- **Zally Ahmadi**, Senior Vice President, Corporate Governance, ESG & Executive Compensation, D.F. King
- **Mark Borges**, Principal, Compensia, and Editor, CompensationStandards.com
- **JT Ho**, Partner, Orrick
- **Jenn Kraft**, EVP & General Counsel, Foot Locker
- **Derek Windham**, Senior Director & Deputy General Counsel, Corporate, Tesla

Among other topics, this program will cover:

- Compensation Planning
- Drafting a Compelling CD&A
- Shareholder Engagement Strategies
- Overcoming Negative Proxy Advisor Recommendations

**<u>“Surviving Say-On-Pay: A Roadmap for Winning the Vote in Challenging Situations”</u>**

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**"Surviving Say-on-Pay: A Roadmap for Winning the Vote in Challenging Situations"**

Course Outline

1. Compensation Planning

   - Assess prior year's Say-on-Pay results, even if you didn't experience a true failure (< 50%) or what traditionally has been considered a "low" Say-on-Pay result that would trigger the need to show responsiveness under proxy advisor policies (<70% for ISS; <80% for Glass Lewis)

     - With Say-on-Pay support generally increasing since the Say-on-Pay votes were mandated, even companies with Say-on-Pay results just below 90% approval are still in the bottom quartile

     - Regulation S-K Item 402(b)(1)(vii) requires disclosure of whether and how you considered the prior year's vote

   - Make your compensation committee aware of pay actions that may cause Say-on-Pay concerns. For example:

     - One-time/special awards (including new hire or retention)

     - Majority of long-term incentives ("LTI") not being performance-based

     - Use of positive discretion or adjustments that result in higher payouts

     - Payouts despite failure to achieve targets

     - Insufficiently rigorous performance goals (including lowering goals from prior years or setting goals below the prior year's performance)

     - Outsized base salaries

     - Excessive perks and gross-up

    - Termination pay/benefits in connection with a retirement or voluntary departure
    - Contracts containing multiyear guarantees for salary increases, nonperformance-based bonuses or equity compensation
    - Use of a peer group for which the company is on the lower end of the selected criteria
    - Compensation that is significantly above the median
  - Understand how your compensation peer group differs from your peers identified by the proxy advisors (*see* ISS's Peer Group FAQ)
  - Consider non-CEO named executive officers ("NEOs") (under Item 402(a)(iii) of Regulation S-K), as well
    - Increasing levels of NEO pay at all levels are being more closely scrutinized as the cost of management grows
    - Companies may still be at risk even when the quantitative evaluations of CEO pay and performance are low concern
    - While one-time non-CEO NEO pay actions used to get little attention, Semler Brossy reported that, in 2024, companies were criticized for:
      - Lack of performance-based NEO equity grants (even where the CEO received performance-based grants)
      - One-time grants to NEOs (not the CEO)
      - High average pay for the NEOs
      - Acceleration of awards for other NEOs at retirement

2. Drafting a Compelling Compensation Discussion & Analysis ("CD&A")
   - Required disclosure under Item 402(b) of Regulation S-K for non-emerging growth companies ("EGCs") and non-smaller reporting companies ("SRCs")

    - Many companies go beyond requirements

    - Some SRCs provide CD&A voluntarily or provide voluntary executive compensation disclosure that has many of the elements of a CD&A, but don't expressly call it a CD&A (especially since they are required to hold Say-on-Pay votes under Exchange Act Rule 14a-21) (*see also* Item 24 of Schedule 14A)

- One of the most commonly cited reasons for Say-on-Pay issues is poor disclosure — specifically, undisclosed performance goals or disclosure that is limited or opaque, particularly with respect to the rationale for compensation decisions

- In a year following low Say-on-Pay support, remember to disclose the details of your engagement program, including the following (*see* ISS's policy on responsiveness below):

    - Data on the number and percentage ownership of shareholders contacted and met with

    - Frequency and timing of engagements

    - Company participants in engagement meetings (including whether independent directors participated)

    - Specific concerns voiced by dissenting shareholders that led to the Say-on-Pay opposition ("what we heard")

    - Specific and meaningful actions taken to address concerns ("what we did")

- If you have a one-time non-CEO NEO pay action this year, make sure you're using your CD&A to explain the purpose and rationale, almost as much (if not as much) as if that one-time pay action was for your CEO

3. Shareholder Engagement Strategies

    - ISS's policy on responsiveness: "Vote case-by-case on Compensation Committee members (or, in exceptional cases, the full board) and the Say-on-Pay proposal if:

- “The company’s previous Say-on-Pay received the support of less than 70 percent of votes cast. Factors that will be considered are:
    - “The company's response, including:
        - “Disclosure of engagement efforts with major institutional investors, including the frequency and timing of engagements and the company participants (including whether independent directors participated);
        - “Disclosure of the specific concerns voiced by dissenting shareholders that led to the Say-on-Pay opposition; and
        - “Disclosure of specific and meaningful actions taken to address shareholders' concerns;
    - “Other recent compensation actions taken by the company;
    - “Whether the issues raised are recurring or isolated;
    - “The company's ownership structure; and
    - “Whether the support level was less than 50 percent, which would warrant the highest degree of responsiveness.
- “The board implements an advisory vote on executive compensation on a less frequent basis than the frequency that received the plurality of votes cast.”

- Glass Lewis policy on responsiveness: “When companies receive a significant level of shareholder opposition to a Say-on-Pay proposal, which occurs when more than 20% of votes on the proposal are cast as AGAINST and/or ABSTAIN, we believe the board should demonstrate a commensurate level of engagement and responsiveness to the concerns behind the disapproval, with a particular focus on responding to shareholder feedback. When assessing the level of opposition to Say-on-Pay proposals, we may further examine the level of opposition among disinterested shareholders as an independent group. While we recognize that sweeping changes cannot be made to a compensation program without due consideration, and that often a majority of shareholders may have voted in favor of the proposal, given that the average approval rate for Say-on-Pay proposals is about 90%, we believe the compensation committee should provide some level of response to a significant vote against. In general, our expectations regarding the minimum appropriate levels of responsiveness will correspond with the level of shareholder opposition, as expressed both through the magnitude of opposition in a single year, and through the persistence of shareholder disapproval over time.

"Responses we consider appropriate include engaging with large shareholders, especially dissenting shareholders, to identify their concerns, and, where reasonable, implementing changes and/or making commitments that directly address those concerns within the company's compensation program. In cases where particularly egregious pay decisions caused the say on pay proposal to fail, Glass Lewis will closely consider whether any changes were made directly relating to the pay decision that may address structural concerns that shareholders have. In the absence of any evidence in the disclosure that the board is actively engaging shareholders on these issues and responding accordingly, we may recommend holding compensation committee members accountable for failing to adequately respond to shareholder opposition. Regarding such recommendations, careful consideration will be given to the level of shareholder protest and the severity and history of compensation practices."

- Showing "responsiveness" to engagement
    - Takes different forms and, in addition to program changes, can also be in the form of commitments
    - Equilar reports that compensation program changes following low Say-on-Pay support now reflect more fine-tuning of the program (*e.g.*, metrics or weighting adjustments) rather than massive shifts

- In engagement meetings:
    - Be thoughtful about the company representatives that you include
        - It is important that the participants understand the issues involved and are able to address the company's position and respond to questions
        - It is usually best to use a cross-functional team that includes investor relations, legal and HR
        - Participation by the chair of the compensation committee provides firsthand information about the decision-making process, but you should be thoughtful about which investors they should meet with given the time commitment involved
    - Be open-minded
    - This should be primarily a listening exercise; don't make commitments
    - Don't be surprised if you hear differing perspectives from various institutional investors and proxy advisors (*e.g.*, on appropriate metrics or preferred equity award types)
    - Avoid being defensive
    - Avoid sharing material nonpublic information, whether orally or through written materials
    - If engagement is during proxy season, written materials may need to be filed

4. Overcoming Negative Proxy Advisor Recommendations

- Prepare in advance to avoid a negative recommendation being a surprise

- ISS and Glass Lewis both make their voting guidelines publicly available and disclose changes to their policies on an annual basis
- The potential for a negative recommendation should be communicated to management and the board of directors
- Flagging a potential recommendation to the compensation committee in advance of making compensation decisions may help to avoid a Say-on-Pay failure
- Understanding potential recommendations can also assist in crafting the messaging in the CD&A, which may reduce the likelihood that an investor will follow a negative proxy advisor recommendation on a particular matter
- It may also be possible to engage directly with the proxy advisors on potential areas of concern during the off-season, but companies should not expect to persuade proxy advisors to change their policies or make exceptions to them

- A negative recommendation from ISS or Glass Lewis is not necessarily fatal
    - The impact of a negative recommendation from ISS decreased to 23% in 2024 (based on data from WTW)
    - A number of the companies that received less than 75% support in 2024 received split recommendations from ISS and Glass Lewis in the 2024 proxy season, according to Semler Brossy research
- Making your case with shareholders
    - It is seldom productive to focus on why you think that recommendations from ISS or Glass Lewis are wrong
    - It is more productive to focus on the company's rationale and provide an explanation for why decisions were made with a focus on that specific investor's policies (which may differ from those of ISS or Glass Lewis)

- Because you are responding to negative recommendations, you run the risk of being overly defensive and detracting from your overall messaging
- Highlight the positive components of your compensation practices

- Using supplemental proxy materials
  - Companies may file additional soliciting material with the SEC once they receive a negative recommendation in an effort to draw attention to factors that they believe were not fully considered, highlight positive pay practices, disclose future commitments and/or set a foundation for further shareholder engagement
  - Materials like these that do not alter the terms of proposals or include material new information generally need not be delivered to shareholders — they can be delivered to a subset of investors, or sometimes the company opts to file these supplemental materials merely to ensure that it is complying with the proxy rules when it uses the material as talking points with investors
  - When it comes to what to say in these materials, the [Checklist: "Proxy Advisors — Handling Negative Recommendations"] on *TheCorporateCounsel.net* has the following recommendations:
    - No Prescribed Format: There is no prescribed format for these supplemental materials. They typically are short one- to two-page documents, often in the form of a letter. The letter can come from the board or management, and even occasionally from a company's compensation consultant.
    - Build Your Case: The goal is to build your case in these materials, so, you want to focus on your argument and not overly restate the background already disclosed in your proxy statement.
    - Response Tactics: One decision point is whether to even bother mentioning the negative recommendation in the supplemental materials. Doing so helps bring focus to your

arguments, but doing so also makes the materials seem defensive — as well as makes it seem that the proxy advisor's position is more important than the positions of your shareholders. Remember that the proxy advisor voting reports are not publicly available — so although there may be leaks, the news of a negative recommendation is not always in the public domain.

- Don't Slam Proxy Advisor: For the first few years under Say-on-Pay, companies filed supplemental letters with the SEC if they received a negative proxy advisor recommendation, particularly if they received one from both ISS and Glass Lewis. Those supplemental materials initially addressed all of the flaws with ISS and Glass Lewis and their methodology — but that approach did not prove to be effective with shareholders. So, most supplemental materials have now evolved into more positive filings that explain the company's story.

- Don't Complain: Since your top 25 investors are likely going to have their own policies, avoid haranguing about Glass Lewis or ISS when you engage them. They are really not interested and, in fact, might be insulted because they have their own policies. The bottom line is that they want you to understand where they are coming from. Focus on what your investors want to hear, not on what you want to complain about.