Changes Due to 2011 Say on Pay Voting Results

A Look at Early Responses

Introduction

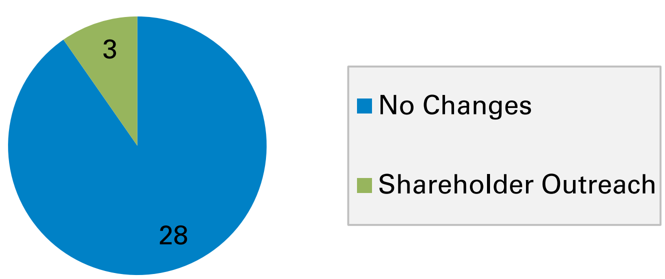
In January 2011, the SEC issued the final rule for amendments to Item 402(b) of Regulation S-K. The rule requires public companies to address in their CD&A if the results of their most recent Say on Pay advisory vote factored into their compensation policies, and if so, how.

Equilar analyzed early responses to 2011 Say on Pay voting results found in the proxies filed so far in 2012. This article will provide an overview of the responses, and highlight changes that companies are making to more closely link executive compensation to financial performance. While there is no one-size-fits-all to compensation practices, these examples illustrate some of the most common approaches.

Voting Analytics

For this analysis, we studied proxies filed between January 1, 2012 and March 1, 2012. We found 31 proxies filed by companies that passed their 2011 Say on Pay vote, and discussed those voting results in the proxy. Twenty-eight (28) companies stated that no significant changes were made as a result of the vote, since they received overwhelming majority approval. Three (3) companies indicated they conducted shareholder outreach and/or made changes due to a close vote in approving Say on Pay.

Response to 2011 Say on Pay Results



In addition we searched for mentions of compensation program changes made by companies whose Say on Pay vote did not pass. While most of the changes are typically required disclosure in proxies, some companies were eager to begin to address their voting results and filed 8-Ks that disclosed actions taken toward achieving future shareholder approval, several months prior to their 2012 proxy statement.

Of the 38 Russell 3000 companies whose shareholders did not approve their 2011 Say on Pay vote, 10 stated that they had taken some action to address shareholder concerns. These actions included engaging a new independent executive compensation consultant, holding discussions with institutional investors, or directly adopting changes. The remaining 28 had not filed their 2012 proxy by this study's cut-off date, and have yet to issue a response to their failed Say on Pay vote.

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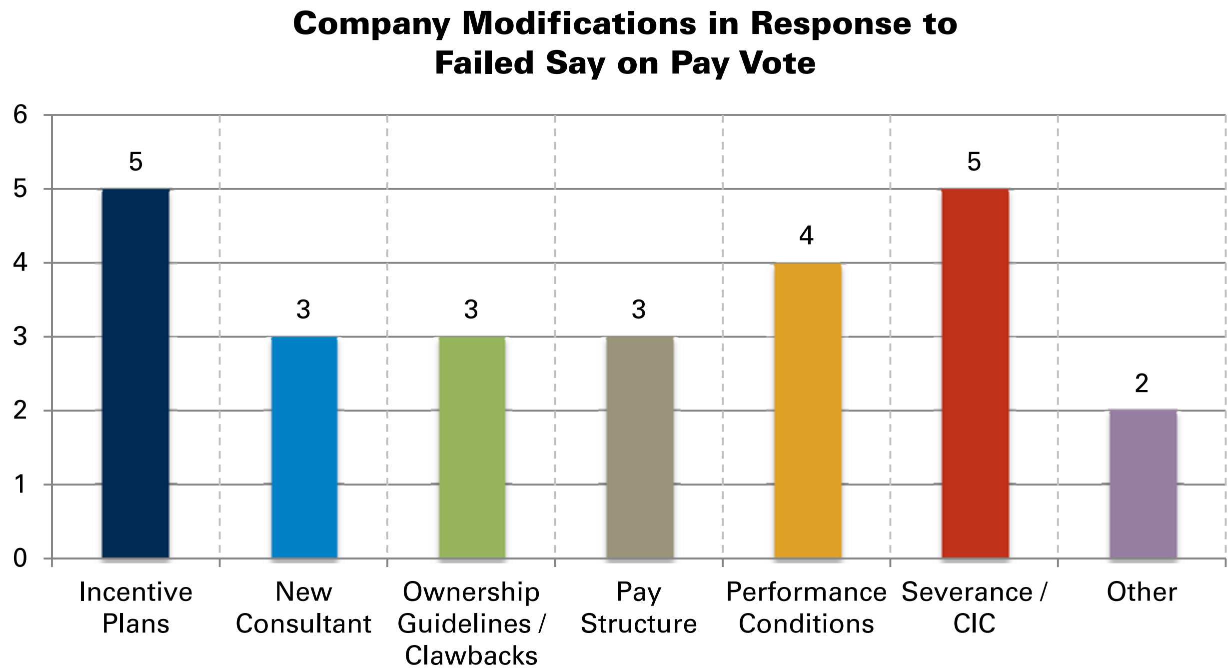
The chart below categorizes the changes made by the 10 companies that failed to pass their Say on Pay vote. Most companies made more than one change to their pay policies as a result of the failed vote. Each of the categories can include additions, modifications, and eliminations involving each category.



Disclosure Examples

Below are some examples of disclosure provided during the last three months relating to 2011's Say on Pay votes. These examples include responses to passing votes, and the different approaches companies took to address a failure to pass 2011's Say on Pay vote.

Disclosure Examples: Response to Passed 2011 Say on Pay

Disclosed responses to 2011's votes are not just concentrated among those companies where approval failed. Companies whose shareholders approved the 2011 Say on Pay vote included a section in their CD&A dedicated to their response to Say on Pay votes. Some companies simply included a short paragraph citing overwhelming approval rates and a lack of change as a result of the vote. Other companies, particularly those with relatively low rates of approval, conducted shareholder outreach programs and instituted changes in an effort to raise approval levels. Below is an example of each type of response.

- **Toll Brothers, Inc. (TOL)**
  DEF 14A filed on February 3, 2012

  "The Compensation Committee considered the results of the 2011 advisory, non-binding "say-on-pay" proposal in connection with the discharge of its responsibilities. Because 99% of our shareholders voting on the "say on pay" proposal approved the compensation of our NEOs described in our proxy statement in 2011, the Compensation Committee did

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not implement significant changes to our executive compensation program as a result of the shareholder advisory vote."

- **NRG Energy, Inc. (NRG)**
  PRE 14A filed on February 29, 2012

  "At last year's Annual Meeting of Stockholders, the first advisory vote on executive compensation was held. The vote was approved, on an advisory basis, with approximately 60% voting in favor of the proposal. Following the Annual Meeting, and through July 2011, the Company's Investor Relations group, supported by members of the Human Resources group, conducted an extensive outreach program to discuss the Company's compensation practices with NRG's largest stockholders to determine the following:
  - why certain stockholders voted for or against the Company's compensation practices;
  - what were the positive elements of the compensation design; and
  - what new or different elements the stockholders would recommend regarding the Company's executive compensation program.

  Through this process, it was clear that the focus of stockholders is threefold: (i) on the continual growth of Free Cash Flow and EBITDA; (ii) better aligning pay with performance, particularly as it relates to the Company's return of capital to stockholders; and (iii) increasing the performance-based metric in the Company's LTIP.

  Following this extensive outreach, management presented the results of these discussions to the Committee in July 2011, at which point the Committee, in consultation with Frederic W. Cook, evaluated potential adjustments to the Company's executive compensation design. At this meeting, management and the Committee came to an agreement as to the direction of the changes to the Company's compensation practices, which were then presented in more detail to the Committee in October 2011. Following the October meeting, management made a final assessment of the changes to ensure that they aligned with the feedback received from the Company's stockholders and presented a revised the AIP design and modified the LTIP awards to the Committee for final approval in November 2011."

Disclosure Examples: Responses to Failed 2011 Say on Pay

Of the companies that failed their 2011 Say on Pay vote, responses range from detailed explanations of changes they made in several compensation areas, to a few paragraphs from companies confident that their failed vote was a result of one particular plan provision. Most commonly, companies chose to modify their long-term and annual incentive plans. Other changes include the adoption of clawback policies and ownership guidelines, and the elimination of tax gross-ups. Notably, Shuffle Master attributed their failure to a negative proxy advisor recommendation and contended that their future Say on Pay vote would be ameliorated by a single change that caters to the firm. Disclosure examples of these changes are provided below.

- **Beazer Homes USA, Inc. (BZH)**

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DEF 14A filed on December 22, 2011

"At the stockholders meeting held on February 2, 2011, 54% of stockholders voting on our "Say on Pay" proposal voted against the executive compensation for our NEOs set forth in our 2011 proxy statement. In response, our Board of Directors and the Committee completed an in-depth review of our pay practices. As part of this review, management contacted several major stockholders in order to better understand the reasons behind the votes against the compensation for our NEOs. Following this assessment process, our Board of Directors took the actions described below to change our compensation practices and programs:

- Reevaluated NEO Total Compensation — In an effort to more closely align compensation with recent performance and the relative size of the Company against the 2012 Peer Group, established total compensation for our CEO at the 25th percentile of the 2012 Peer Group and between the 25th and 50th percentile of the 2012 Peer Group for other NEOs.
- Increased Emphasis on Performance-Based Equity Compensation — Established a 2012 long-term incentive program for NEOs with a significant component being performance-based shares. Key features of the 2012 long-term incentive plan are:
    - Equity grants divided evenly in number between performance-based shares and stock options.
    - In order for performance-based shares to vest, our stock price must achieve both an absolute aggressive compound annual growth rate and significant relative total shareholder returns measured against the 2012 Peer Group. See chart below under "— Elements of Fiscal Year 2012 Executive Compensation — Long-Term Incentive Compensation".
    - Performance-based shares only earned if performance targets achieved at the end of a three-year measurement period (i.e., no interim or pro rata vesting or performance snapshot).
    - At the time of grant, equity grant values were significantly below the value each NEO was entitled to receive pursuant his respective employment agreement. These values will only be received if there is significant appreciation of the Company's stock price, in both absolute terms and relative to the 2012 Peer Group.
- Established Aggressive Bonus Plan Targets — Established a 2012 annual bonus plan that focuses bonus opportunity on the achievement of aggressive goals related to improvements in earnings before interest, taxes, depreciation and amortization ("EBITDA"), balance sheet metrics and customer-related metrics. For fiscal year 2012, the Committee will not approve any bonus amount where performance does not meet these pre-established levels.
- Elimination of Tax Gross-Ups and Modified-Single Trigger Change of Control Provisions —Terminated existing agreements for NEOs that included tax gross-up provisions and modified-single trigger change of control provisions.
- Substantially Reduced Severance Payments and Eliminated Post-Termination Benefits — In the new employment agreements with NEOs, set severance payments at levels substantially below those previously used and eliminated post-termination payment of benefits (such as health and welfare benefits).

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- o <u>Elimination of Evergreen Employment Agreements</u> — New employment agreements with NEOs have a four-year term that does not automatically renew.
- o <u>Elimination of Certain Incentive Plans</u> — MT Plan to be eliminated following completion of the 2011-2012 performance cycle.
- o <u>Reinstituted an Executive and Director Stock Ownership Policy</u> — Reinstituted an executive and outside director stock ownership policy, which also provides for holding periods for a significant portion of net after-tax shares issued upon vesting of restricted stock or exercised stock options in order to facilitate progress towards meeting stock ownership requirements.
- o <u>Adoption of a Compensation Clawback Policy</u> — Adopted a policy for clawing back compensation of executive officers in select circumstances.
- o <u>New Direction for Compensation in 2012 and Beyond</u> — Retained new compensation consultants with in-depth knowledge of current compensation best practices and peer group practices."

- **Cogent Communications Group, Inc. (CCOI)**
  DEF 14A filed on March 2, 2012

  "At the Company's annual meeting in 2011 the stockholders did not approve the compensation of the named executive officers. Based on the views expressed by several stockholders this occurred because the Board cancelled options and replaced them with restricted stock for one of the named executive officers. The Board and Compensation Committee do not intend to do so again. The Board has amended the 2004 Incentive Plan to prohibit such actions as well as to prohibit the re-pricing of options that have a strike price below the current price of the Company's stock ("underwater options") unless such action is approved the stockholders."

- **Shuffle Master, Inc. (SHFL)**
  DEF 14A filed on February 3, 2012

  "At the March 17, 2011 Annual Meeting of Shareholders, the shareholders of the Company voted, on an advisory basis, against approval of the named executive officer compensation disclosed in our proxy statement dated as of February 4, 2011. The Company believes that the negative shareholder vote was a result of the issuance on February 17, 2011 of the ISS Proxy Advisory Services report (the "Report"), which contained a recommendation against such advisory vote based solely on the inclusion of the "modified single trigger" provision in the employment agreement of Mr. David B. Lopez, the Company's Executive Vice President and Chief Operating Officer, in effect at such time.

  On May 24, 2011, the Company amended Mr. Lopez's employment agreement, with the primary change being the deletion of the provision that permits the termination of the employment agreement by Mr. Lopez and the receipt of certain benefits upon a "change of control" of the Company. Under the amended and restated employment agreement, Mr. Lopez may only terminate his employment agreement "for good reason" in the event of a change of control if there is also a material reduction in the nature or scope of his duties, responsibilities, authority, or position, including, but not limited to, removal or expulsion

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from the Board of Directors without Cause, as such term is defined within such agreement. These changes removed the "modified single trigger" mechanism referred to in the Report.

As the Company does not include "single trigger" or "modified single trigger" change of control provisions in any executive officer employment agreements, the Company believes that it has remedied the sole basis for ISS previous recommendation to vote against the advisory vote."

Disclosure Examples: Changes to Long-Term Incentive Plans and Annual Incentive Plans

- **Hewlett Packard Co. (HPQ)**
  DEF 14A filed on February 3, 2012

  "During fiscal 2011, we conducted a comprehensive review of our long-term incentive program. Upon completion of that review, the Committee approved a new structure for long-term incentive awards granted beginning in fiscal year 2012. Under the new structure, our senior executives will receive three types of equity awards:
  - Performance-contingent stock options, which will vest only if the service requirement is met and HP's stock price appreciates above specified thresholds within four years from the date of grant (for fiscal 2012 awards, the thresholds, each applicable to 50% of the award, will be 20% and 40% appreciation over the exercise price);
  - Performance-based restricted unit awards, which will vest only if cash flow and revenue growth goals are achieved above a threshold level of performance; and
  - Time-based restricted stock units, which will vest over a three-year period rather than a two-year vesting period, as was applicable to previous awards.

  Two of these three types of equity awards, representing 70% of our executive officers' total long-term incentive compensation, contain performance conditions, thereby ensuring that a substantial portion of our executive officers' long-term incentive compensation is linked to the achievement of financial performance goals. This places a significant emphasis on the achievement of financial performance goals and stock price performance and provides a strong linkage between pay and performance. The remaining 30% of our executive officers' long-term incentive compensation is awarded in the form of time-based restricted stock units and is intended to promote retention."

- **Helix Energy Solutions Group, Inc. (HLX)**
  8-K Exhibit 99.1 filed on January 30, 2012

  "We welcome the opportunity to engage our shareholders regarding topical matters and would like to update you regarding actions the Compensation Committee has taken with regard to executive compensation following the annual shareholders meeting held on May 11, 2011. The following is a summary of those actions, which are designed to more closely link executive compensation with the financial performance of the Company.

  - <u>Design of 2011 short-term incentive bonus program</u>: Subsequently, in June 2011, The Compensation Committee determined the metrics for the 2011 short-term cash

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incentive bonus. For the Company's Chief Executive Officer, Chief Financial Officer, General Counsel and Chief Accounting Officer, the performance metrics consist of the following: (i) 40% based on the achievement by the Company of certain EBITDAX (earnings before interest, taxes, depreciation, amortization and exploration expense) targets; (ii) 40% based on total shareholder return (TSR) of the Company's stock for 2011 relative to that of the compensation peer group previously selected by the Committee; and (iii) 20% based on personal objectives. For the Company's Executive Vice President Oil & Gas and the Executive Vice President-Contracting Services, the performance metrics consist of the following: (i) 25% based on the achievement by the Company of certain EBITDAX targets; (ii) 25% based on the achievement by the officer's respective business unit of certain EBITDAX targets; (iii) 25% based on Company TSR for 2011 relative to that of its peer group; and (iv) 25% based on personal objectives. (This information is more particularly described in the Current Report on Form 8-K that we filed on June 16, 2011.)"

- **Johnson Controls, Inc. (JCI)**
  DEF 14A filed on January 11, 2012

  "Specific changes for fiscal 2012 include:
  - A substantial increase in the level of earnings growth (to 10%) required to earn incentive awards under both our Annual and Long-Term Incentive Performance Plans to better align incentives with the growth expectations of our investors.
  - Adding Return on Sales (ROS) to our Annual Incentive Performance Plan to focus on margin expansion, which is a key area of focus by our institutional shareholders."

- **NRG Energy, Inc. (NRG)**
  PRE 14A filed on February 29, 2012

  "As a result, for 2012, changes have been made to both the AIP compensation and the LTIP compensation to increase alignment of executive compensation with stockholder focus. The Company has retained the financial AIP goal of Consolidated Adjusted Free Cash Flow and Consolidated Adjusted EBITDA to continue to focus on the importance of cash flow and long-term growth, while increasing individual performance metrics as they relate to the Company's Capital Allocation Plan. This change is designed to bring individual focus to returning capital to the Company's stockholders. In addition, the grants under the LTIP will now be 33% RSUs and 67% MSUs. MSUs are restricted grants where the quantity of shares increases and decreases alongside TSR. These changes will more closely align pay with performance."

Disclosure Examples: Adoption of Clawback Policies and Ownership Guidelines

- **Pico Holdings, Inc. (PICO)**
  8-K filed on January 30, 2012

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"1. We established stock ownership guidelines for directors and executive officers. These guidelines are intended to help ensure that our Board and management maintain an equity stake in the Company, and by doing so, link their interests with those of other shareholders. The guidelines require ownership by the CEO of the lesser of 275,000 shares or stock with a value of three times his base salary, with smaller ownership requirements for the CFO and other designated executive officers. The guidelines for directors specify ownership of the lesser of 5,000 shares or stock with a value of three times the annual cash retainer for Board service.

2. We adopted a cash incentive compensation repayment ("clawback") policy. This policy requires our CEO, CFO and other designated executive officers to repay to us the amount of any annual cash incentive that he or she received to the extent that: (1) the amount of such payment was based on the achievement of certain financial results that were subsequently the subject of the restatement that incurs within 12 months of such payment; (2) the executive officer engaged in theft, dishonesty or intentional falsification of documents or records that resulted in the obligation to restate our financial results; and (3) a lower cash incentive would have been paid to the executive officer based on the restated financial results. We intend to amend our clawback policy to comply with the additional requirements of the Dodd-Frank Act after the SEC adopts new regulations implementing those requirements."

Disclosure Examples: Elimination of Tax Gross-Ups

- **BioMed Realty Trust, Inc. (BMR)**
  8-K filed on January 31, 2012

  "On January 25, 2012, the Compensation Committee of the Board of Directors of BioMed Realty Trust, Inc. (the "Company"), as a result of an extensive re-evaluation of the Company's executive compensation program, adopted a number of significant changes to the Company's executive compensation program, including: [...] Terminating existing employment agreements, resulting in the elimination of [...] potential excise tax gross-up payments."

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