EQUITY PLAN PROPOSAL FAILURES: 2007–2012

EXEQUITY

Independent Board and Management Advisors

2012

Lessons to Consider When Requesting Shares

This white paper looks at the equity plan proposals that have failed during 2007–2012, how Institutional Shareholder Services Inc. viewed the proposals, and key takeaways from these votes.

Equity Plan Proposal Failures: 2007–2012

LESSONS TO CONSIDER WHEN REQUESTING SHARES

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INTRODUCTION

Ever since the exchange listing rules were modified to require shareholder approval of almost all equity compensation plans,[1] there has been an ever-increasing focus on securing shareholder approval for equity plan proposals, both new equity plans and amendments to existing plans. The stakes are higher now that shareholder approval is required. So how did voting on equity plan proposals go during the past five years (2007–2012)?

Overall, there were approximately **4,800** equity plan proposals submitted to shareholders of Russell 3000 Index companies for the period 2007–2012. Of these proposals, only **54** failed to be approved by shareholders.

The rest of this report looks at the voting on these equity plan proposals and then focuses on the 54 proposals that failed to see what, if any, lessons can be learned. Hopefully, these lessons will prove valuable for companies seeking shareholder approval of their own equity plan proposals.

Of the 4,800 equity plan proposals at Russell 3000 companies from 2007–2012, only 54 failed (1.2%).

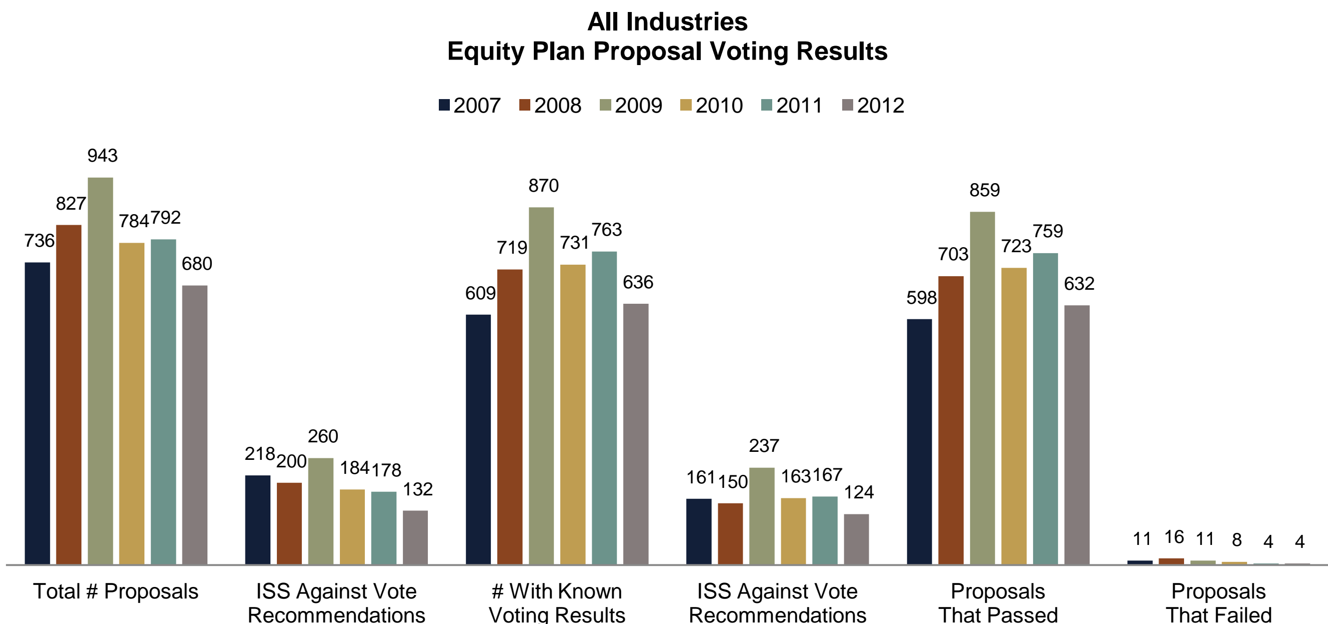
[1] The SEC approved changes to the NYSE and NASDAQ listing requirements to require shareholder approval of most equity compensation plans in June 2003, *see* SEC Release No. 34-48108 (June 30, 2003), available at http://www.sec.gov/rules/sro/34-48108.htm.

VOTING ON PLAN PROPOSALS

As mentioned in the introduction, there were approximately **4,800** equity plan proposals submitted to shareholders for consideration during the 2007 to 2012 period. The overwhelming majority of these proposals were approved by shareholders. Only a small number of equity plan proposals actually failed to gain shareholder approval (1.2%).

Given their influence among institutional investors, it is also important to review the voting recommendations *Against* equity plan proposals by Institutional Shareholder Services Inc. (ISS) and how these compared to the actual equity plan proposals that failed. ISS typically "grades on a curve" and strives to recommend *Against* one-third of all equity plan proposals. In recent years, ISS has fallen a bit below that target, only recommending *Against* 25 to 30 percent of equity plan proposals.

The natural question to ask is what is the significance of a negative ISS vote recommendation for an equity plan proposal? Does it doom the proposal to failure? Well, as with most things, it depends on the particular facts and circumstances, but generally it looks like a negative ISS vote recommendation in the aggregate has very little bite. However, that may not be true for certain industry groups (see the Industry Voting Information section that follows) or for companies whose significant shareholders follow the ISS vote recommendations. In the chart below, you can see that while ISS recommended *Against* between 132 and 260 plans each year, no more than 16 equity plan proposals ever actually failed to win approval from shareholders in a single year (and there were less than five failures for each of the past two years). Of course, these are results of proposals actually put to a shareholder vote. However, companies that did a preliminary assessment using the ISS model and discovered that ISS would recommend *Against* their request and therefore did not put forward any proposal are not represented. Based on the authors' anecdotal experience, at least several dozen companies fall into this category each year.



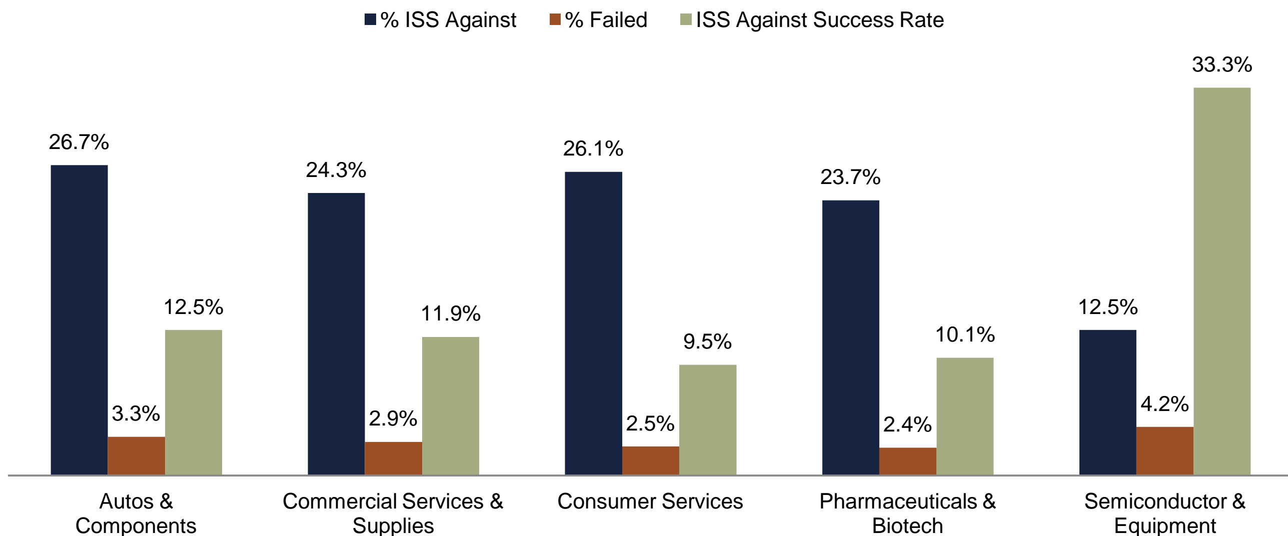
INDUSTRY VOTING INFORMATION

Given that an ISS negative vote recommendation does not appear to signify any significant risk of an equity plan proposal's failure in the aggregate (noting that there has been some self-selection at work in so far as companies ostensibly pursued shareholder approval of their proposals only when they believed approval was most likely), we thought it prudent to take a closer look to see if the same holds true for equity plan proposals on an industry basis. Therefore, we cut the data to look at the voting results on an industry basis and were somewhat surprised by the results.

While the overall failure rate for equity plan proposals over the past three years averaged less than 2 percent, there are quite a few industries where the risk is significantly less and several where the risk of proposal failure is significantly higher. Seven of the 24 industry groups had no equity plan proposal failures at all, eight had one or two failures, while nine industries had three or more equity plan proposal failures.

The top five industry groups for equity plan proposal failures for 2007–2012 had equity plan proposal failure rates of about 3 percent. These industry groups are as follows, on a percentage of total proposals basis, in descending order of failure percentage rate:

- Semiconductor & Equipment
- Autos & Components
- Commercial Services & Supplies
- Consumer Services
- Pharmaceuticals & Biotech



The equity plan proposal failure rate for proposals in these five industries was more than double the average failure rate for all industry groups. These five industries also represent the industries where ISS's vote recommendations had the highest level of success, as measured by the number of proposals ISS recommended *Against* compared to the number that ultimately failed. ISS's success rate for its negative vote recommendations was as high as about 33 percent for the Semiconductor & Equipment industry, and tapered down to about 9 percent for the Consumer Services industry group.

A summary of the voting on equity plan proposals by industry group appears below. We have also indicated, by industry group, the ISS Against vote recommendation and the proposals as failed. Finally, we calculated the ISS Against Success Rate to illustrate how often the ISS Against vote recommendations for each industry resulted in equity plan proposals failing.

Industry Voting Information: 2007–2012

Industry	# Proposals[1]	# ISS Against	% ISS Against	# Failed	% Failed	ISS Against Success Rate
Autos & Components	30	8	26.7%	1	3.3%	12.5%
Banks	289	87	30.1%	2	0.7%	2.3%
Capital Goods	363	69	19.0%	0	0.0%	0.0%
Commercial Services & Supplies	173	42	24.3%	5	2.9%	11.9%
Consumer Durables & Apparel	139	42	30.2%	1	0.7%	2.4%
Consumer Services	161	42	26.1%	4	2.5%	9.5%
Diversified Financials	153	64	41.8%	2	1.3%	3.1%
Energy	313	93	29.7%	4	1.3%	4.3%
Food Beverage & Tobacco	97	24	24.7%	0	0.0%	0.0%
Food Staples & Retailing	40	7	17.5%	0	0.0%	0.0%
Health Care Equipment & Services	359	66	18.4%	4	1.1%	6.1%
Household & Personal Products	28	1	3.6%	0	0.0%	0.0%
Insurance	113	27	23.9%	0	0.0%	0.0%
Materials	179	33	18.4%	1	0.6%	3.0%
Media	96	32	33.3%	2	2.1%	6.3%
Pharmaceuticals & Biotech	334	79	23.7%	8	2.4%	10.1%
Real Estate	175	34	19.4%	2	1.1%	5.9%
Retailing	211	58	27.5%	3	1.4%	5.2%
Semiconductor & Equipment	192	24	12.5%	8	4.2%	33.3%
Software & Services	359	82	22.8%	4	1.1%	4.9%
Tech Hardware & Equipment	274	46	16.8%	2	0.7%	4.3%
Telecom Services	54	14	25.9%	0	0.0%	0.0%
Transportation	90	17	18.9%	1	1.1%	5.9%
Utilities	106	5	4.7%	0	0.0%	0.0%
All Industries	**4,328**	**996**	**23.0%**	**54**	**1.2%**	**5.4%**

[1] With known voting results.

ISS Against Success Rate = # Failed / # ISS Against.

The bold industries represent the top five industries for plan proposal failures, and the top five for ISS's Against Success Rate.

PROPOSALS THAT FAILED

The devil is typically in the details. So, we dug into the 54 equity plan proposals that actually failed during 2007–2012 to see what we could learn that might shed some light on *why* these particular proposals failed. Again, we note that there was some initial self-selection at work in so far as companies typically only seek shareholder approval of an equity plan proposal when they are confident of gaining shareholder support.

The chart below details the company plan proposals by year that failed to secure shareholder approval. The chart also indicates the percent of the common shares outstanding as of the record date represented by the plan proposal, the fully diluted dilution represented by the plan proposal, and ISS's Shareholder Value Transfer (SVT) for the proposal as well as the SVT cap for the company at the time.

Proposals That Failed: 2007–2012

Company	Year	% of CSO[1]	Dilution	SVT	SVT Cap
Acacia Research Corporation[2]	2012	30.2%	**27%**	36%	14%
Affymax, Inc.[2]	2012	0.0%	**26%**	30%	14%
Evercore Partners Inc.	2012	37.9%	**48%**	92%	20%
Uranium Energy Corp.	2012	6.5%	15%	27%	9%
Horsehead Holding Corp.[2]	2011	17.8%	19%	22%	8%
Integrated Silicon Solution, Inc.	2011	15.2%	**28%**	35%	20%
IRIS International, Inc.[3]	2011	24.9%	**30%**	16%	16%
Valassis Communications, Inc.	2011	4.0%	**20%**	18%	14%
Abercrombie & Fitch Co.	2010	4.3%	17%	10%	10%
FBR & Co.	2010	14.5%	**34%**	45%	16%
ICU Medical, Inc.	2010	4.4%	**25%**	16%	13%
Omnicell, Inc.	2010	8.9%	**22%**	19%	14%
Oriental Financial Group Inc.	2010	1.6%	3%	5%	5%
PDF Solutions, Inc.[2]	2010	0.0%	**51%**	97%	20%
Republic Airways Holdings Inc.	2010	14.5%	**25%**	28%	15%
Standard Microsystems Corporation	2010	13.3%	**25%**	20%	16%
Advanced Analogic Technologies Incorporated[2]	2009	24.1%	**33%**	42%	20%
Exelixis, Inc	2009	3.8%	**29%**	25%	16%
Harvest Natural Resource, Inc	2009	2.1%	13%	15%	8%
Hot Topic, Inc.	2009	4.5%	19%	16%	11%
Huron Consulting Group, Inc.	2009	11.6%	16%	18%	11%
Palomar Medical Technologies, Inc.	2009	11.1%	**26%**	24%	14%
Perma-Fix Environmental Services, Inc.	2009	1.8%	9%	6%	17%
Pharmasset, Inc.	2009	2.1%	13%	11%	15%
Sequenom, Inc.	2009	2.5%	15%	14%	17%
Ultratech Inc.	2009	0.0%	**20%**	17%	20%

Company	Year	% of CSO[1]	Dilution	SVT	SVT Cap
VIVUS, Inc.	2009	1.4%	10%	12%	20%
American Axle & Manufacturing Holdings, Inc.	2008	9.4%	**23%**	23%	7%
Arqule, Inc.	2008	5.5%	17%	17%	13%
Cracker Barrel Old Country Store, Inc.	2008	4.5%	**21%**	19%	11%
Emulex Corporation	2008	2.4%	**20%**	9%	15%
FTI Consulting, Inc.	2008	2.0%	15%	17%	11%
Iconix Brand Group, Inc.	2008	2.6%	19%	22%	12%
IXYS Corp.[2]	2008	11.1%	**31%**	20%	20%
NIC Inc.	2008	15.8%	17%	20%	18%
Outdoor Channel Holdings, Inc.	2008	2.9%	12%	13%	17%
Pain Therapeutics, Inc.	2008	19.0%	**32%**	32%	19%
Radiant Systems, Inc.	2008	10.8%	**26%**	25%	17%
Salesforce.com, Inc.	2008	6.2%	18%	38%	13%
Sigma Designs, Inc.[2]	2008	16.0%	**26%**	37%	20%
T-3 Energy Services Inc	2008	8.0%	17%	18%	9%
The Cheesecake Factory, Inc.	2008	0.0%	**20%**	17%	9%
Wilmington Trust Corp.	2008	6.0%	16%	10%	6%
Arena Resources, Inc.	2007	2.9%	14%	12%	9%
Corporate Office Properties Trust, Inc.	2007	15.2%	19%	23%	6%
Cracker Barrel Old Country Store, Inc.	2007	8.4%	**23%**	20%	9%
Electro Scientific Industries, Inc.	2007	0.0%	**22%**	23%	15%
Illumina, Inc.[2]	2007	9.0%	**26%**	29%	13%
J2 Global Communications, Inc.	2007	20.3%	**36%**	22%	19%
LTC Properties, Inc.	2007	2.5%	5%	3%	6%
Microtune, Inc.	2007	3.7%	**22%**	20%	18%
Penn National Gaming, Inc.	2007	7.0%	18%	18%	9%
Resources Connection, Inc.	2007	4.1%	**21%**	18%	10%
Tuesday Morning Corp.	2007	1.5%	10%	5%	10%

[1] % of CSO is the number of shares represented by the equity plan proposal expressed as a percent of the company's common shares outstanding as of the record date for the applicable proxy.

[2] Company's equity plan proposal involved a plan with an evergreen provision. % of CSO takes into account an estimate of the total number of shares that could be added to a plan during the remaining plan term under the evergreen provision.

[3] ISS's final vote recommendation was *For* the plan proposal, but ISS initially recommended *Against* IRIS International's equity plan proposal.

Bolded dilution figures indicate that dilution from the equity plan proposal would result in dilution of 20 percent or greater.

Dilution is the fully diluted dilution represented by the equity plan proposal, all outstanding equity awards, and all shares available for grant under equity plans that will continue to be available if the proposal is approved, divided by the company's common shares outstanding as of the record date, plus everything in the numerator.

SVT is Shareholder Value Transfer, a term from ISS used to describe the percent of market value of the company (generally 200-day [400-day for 2009] stock price multiplied by common shares outstanding as of the record date), represented by the value calculated by ISS for the equity awards available to be granted under the equity plan proposal, any continuing plans, and for any outstanding equity awards.

SVT Cap, or allowable cap, is the company-specific maximum amount of SVT that ISS permits each company to have after utilizing a black-box regression formula that takes into account the equity award usage at top-quartile performing companies within the same industry group (the performance metrics change from group to group, but tend to include total shareholder return as a significant factor).

We found one instance where ISS recommended *For* an equity plan proposal, yet it failed to secure shareholder approval:

- **IRIS International, Inc.** (2011)—Initially, ISS recommended *Against* IRIS International's plan proposal in its May 5, 2011 proxy report because while its burn rate exceeded the ISS burn rate cap and the company included a burn rate commitment, ISS found it to be inadequate. The company then filed a Form 8-K clarifying its burn rate commitment which ISS accepted. ISS then reissued its proxy report on May 6, 2011 and recommended *For* the plan proposal. The shareholder meeting was held May 20, 2011. It is therefore unclear why the change in ISS vote recommendation on this equity plan proposal did not translate into shareholder approval of the proposal. One potential explanation is that IRIS's voting power dilution (30%) and burn rate (4.5% on an unadjusted basis) would have been considered high by many institutional investors with their own custom voting guidelines.

ISS'S OBSERVATIONS

The reasons ISS recommended *Against* the equity plan proposal that failed are indicated below and span the seven key policies that ISS applies to equity plan proposals:

- Excessive cost to shareholders, i.e., SVT Cost
- Excessive burn rate, i.e., Burn Rate above the industry-specific cap
- Specifically permitting repricing or cash-outs without shareholder approval or remaining silent on repricings after a company has conducted a repricing or exchange without shareholder approval, i.e., Repricing Policy
- Misalignment of pay and performance, i.e., P4P
- Problematic/poor pay practices
- A definition of change in control (CIC) that could be triggered absent consummation of the deal, i.e., Liberal CIC
- Any other egregious compensation practice or action that ISS finds objectionable (typically applied to large, well-known companies that make good poster children), i.e., Other

Reason(s) for ISS Opposition to Equity Plan Proposals: 2007–2012

Company	Year	SVT Cost	Burn Rate	Repricing Policy	P4P Disconnect	Problematic/ Poor Pay Practices	Liberal CIC	Other
Acacia Research Corporation[1]	2012	●	●	●				
Affymax, Inc.[1]	2012	●		●	●			
Evercore Partners Inc.	2012	●	●					
Uranium Energy Corp.	2012	●	●	●				
Horsehead Holding Corp.[1]	2011	●		●				
Integrated Silicon Solution, Inc.	2011	●						
IRIS International, Inc.[2]	2011		●					
Valassis Communications, Inc.	2011	●	●					
Abercrombie & Fitch Co.	2010		●		●	●		
FBR & Co.	2010	●	●					
ICU Medical, Inc.	2010	●			●	●		
Omnicell, Inc.	2010	●	●		●			
Oriental Financial Group Inc.	2010							●
PDF Solutions, Inc.[1]	2010	●		●				
Republic Airways Holdings Inc.	2010	●	●			●		
Standard Microsystems Corporation	2010	●				●		
Advanced Analogic Technologies Incorporated[1]	2009	●	●	●		●		
Exelixis, Inc	2009	●	●					
Harvest Natural Resource, Inc	2009	●				●		
Hot Topic, Inc.	2009	●						
Huron Consulting Group, Inc.	2009	●	●					

Company	Year	SVT Cost	Burn Rate	Repricing Policy	P4P Disconnect	Problematic/ Poor Pay Practices	Liberal CIC	Other
Palomar Medical Technologies, Inc.	2009	●						
Perma-Fix Environmental Services, Inc.	2009			●				
Pharmasset, Inc.	2009			●				
Sequenom, Inc.	2009		●					
Ultratech Inc.	2009			●				
VIVUS, Inc.	2009			●				
American Axle & Manufacturing Holdings, Inc.	2008	●	●					
Arqule, Inc.	2008	●						
Cracker Barrel Old Country Store, Inc.[3]	2008	●					○	
Emulex Corporation	2008							●
FTI Consulting, Inc.	2008	●	●					
Iconix Brand Group, Inc.	2008	●	●					
IXYS Corp.[1]	2008				●			
NIC Inc.	2008	●						
Outdoor Channel Holdings, Inc.	2008			●				
Pain Therapeutics, Inc.	2008	●						
Radiant Systems, Inc.	2008	●						
Salesforce.com, Inc.	2008	●						
Sigma Designs, Inc.[1]	2008	●						
T-3 Energy Services Inc	2008	●	●	●		●		
The Cheesecake Factory, Inc.	2008	●		●				
Wilmington Trust Corp.	2008	●						
Arena Resources, Inc.	2007	●						
Corporate Office Properties Trust, Inc.	2007	●	●	●				
Cracker Barrel Old Country Store, Inc.	2007	●	●					
Electro Scientific Industries, Inc.	2007	●						
Illumina, Inc.[1]	2007	●	●					
J2 Global Communications, Inc.	2007	●		●				
LTC Properties, Inc.	2007			●				
Microtune, Inc.	2007	●		●				
Penn National Gaming, Inc.	2007	●						●
Resources Connection, Inc.	2007	●	●					
Tuesday Morning Corp.	2007			●				

[1] Company's equity plan proposal involved a plan with an evergreen provision.

[2] ISS's final vote recommendation was *For* the plan proposal; initially, ISS opposed the plan proposal due to issues with the company's burn rate commitment.

[3] ISS noted the CBRL proposed plan had a liberal CIC definition. However, this vote occurred prior to the time when ISS changed its policies to recommend *Against* plans that had liberal CIC definitions.

LESSONS LEARNED

While the number of equity plan proposals that failed during 2007–2012 was not large, there are a few key takeaways that should help companies when putting forward an equity plan proposal of their own.

The Influence of Self-Selection

Based on our anecdotal experience, companies typically only seek shareholder approval of an equity plan proposal when they are confident of securing shareholder approval. Companies that are not confident that shareholders would approve their proposal do not put the matter to a shareholder vote. So there is a natural bias in the voting results that favors shareholder approval. Consequently, the psychological impact of an unexpected negative vote recommendation can be quite significant on a company's board and management team.

Dilution

First and foremost in the context of shareholder and proxy advisor reaction to an equity plan proposal, if the dilution caused by the proposal equals or exceeds 20 percent, it is much more likely to fail. One of the main reasons for this is because institutional investors that do not follow ISS vote recommendations use dilution as a primary vote driver. Of the 54 proposals that failed, 30 had dilution which equaled or exceeded 20 percent. But, a review of the failed proposals indicates 45 had dilution equal to or greater than 15 percent, which is a common threshold used by a number of institutional shareholders.[2]

So, all things being equal, an equity plan proposal that results in dilution above 15 or 20 percent will have an increased chance of failing. That's not to suggest that gaining shareholder approval for such a proposal is impossible; it will just take additional work to counteract the increased opposition to such equity plan proposals and, in some cases, the dilution level alone will be sufficient to defeat the proposal.

An equity plan proposal that results in dilution above 15 percent will have an increased chance of failing.

[2] Fifteen percent dilution is used as a proxy voting guideline for Vanguard, The California State Teachers' Retirement System (CalSTRS), and MFS Funds.

SVT Cost

Closely related to the notion of dilution is ISS's SVT cost metric. This metric looks at the economic dilution to shareholders caused by an equity plan proposal. SVT cost looks at the economic value assigned to the equity plan proposal and all shares available under continuing plans and all outstanding equity awards as a percent of a company's market value. The interesting thing is that ISS uses publicly available information to determine how the top-quartile performers in an industry group use equity. With this information, ISS is then able to establish a regression formula it uses to determine the maximum allowed SVT cost it will support for every company in that particular industry group, based on each company's relative performance against those top-quartile performers (the actual performance metrics are part of the ISS "black box" and typically not revealed, but we have found there is typically a strong correlation with a company's relative total shareholder returns). The SVT caps set using the regression formula are ISS's assessment of what size and style of share request would be "reasonable" and could be supported.

The vast majority of equity plan proposals that failed (75.9%) had SVT costs exceeding their SVT caps. Thus, if an equity plan proposal's SVT cost exceeds a company's SVT cap, it looks like there is an increased risk that the proposal will fail. Again, this risk can be addressed by going directly to shareholders and explaining the rationale for the equity plan proposal, but not all shareholders are open to such arguments and companies would be wise to understand the risks presented by such a situation and plan accordingly.

Three-quarters of equity plan proposals that failed had "excessive" SVT costs, i.e., their SVT cost exceeded their company-specific SVT cap.

Burn Rate

While burn rate was not cited by ISS for recommending against a majority of the equity plan proposals that failed, it nevertheless was cited for over a third (38.9%) of the failed proposals. Even then, in all but one of the failed proposals where excessive burn rate was cited, ISS also cited SVT cost being above the company's SVT cap. Additionally, even if an equity plan proposal were to face an increased failure risk due to potentially excessive burn rate under ISS's policies, a company could commit to maintain its burn rate at a specified rate over the next three years and ISS would likely give the company a pass on the burn rate policy, i.e., ISS would not recommend *Against* the proposal if excessive burn rate was the only issue it found with the proposal. There is no such "out" for companies that fail ISS's SVT cost policy.

Burn rate is also a primary vote driver for institutional investors with their own custom voting guidelines. In fact, for many large institutional investors, burn rate is weighted more heavily in their analysis than voting power dilution. There are several different ways to calculate burn rate (gross versus net, for example) and many different acceptable thresholds. Also, some independent institutional investors are putting a multiplier on full-value awards although the multiplier is usually static and not based on stock price volatility like ISS.

Although there is no "golden rule" with respect to an acceptable burn rates, it should be noted that of the 21 companies ISS cited as having a burn rate issue, 18 companies (85.7%) had a three-year unadjusted burn rate of greater than 3 percent. Issuers need to pay close attention to their top holders and what an acceptable burn rate will be regardless of a company's specific burn rate.

Burn Rates for Proposals That Failed: 2007–2012

Company	Year	ISS Adjusted 3-Year Average Burn Rate	ISS Burn Rate Cap	Unadjusted 3-Year Average Burn Rate
Acacia Research Corporation	2012	**5.40%**	4.61%	3.60%
Affymax, Inc.	2012	6.01%	7.49%	5.69%
Evercore Partners Inc.	2012	**25.94%**	9.15%	12.97%
Uranium Energy Corp.	2012	**4.33%**	4.02%	4.01%
Horsehead Holding Corp.	2011	1.05%	3.04%	0.70%
Integrated Silicon Solution, Inc.	2011	5.04%	6.64%	4.95%
IRIS International, Inc.	2011	**5.83%**	4.66%	4.45%
Valassis Communications, Inc.	2011	**5.93%**	4.10%	5.64%
Abercrombie & Fitch Co.	2010	**4.02%**	3.10%	3.27%
FBR & Co.	2010	**21.20%**	5.15%	12.38%
ICU Medical, Inc.	2010	1.83%	3.65%	1.83%
Omnicell, Inc.	2010	**3.73%**	3.65%	3.41%
Oriental Financial Group Inc.	2010	0.58%	2.05%	0.47%
PDF Solutions, Inc.	2010	5.98%	7.31%	5.90%
Republic Airways Holdings Inc.	2010	**3.63%**	2.13%	3.46%
Standard Microsystems Corporation	2010	2.52%	4.82%	2.26%
Advanced Analogic Technologies Incorporated[1]	2009	**5.80%**	5.72%	5.80%
Exelixis, Inc	2009	**5.96%**	5.76%	5.85%
Harvest Natural Resource, Inc	2009	2.56%	3.09%	2.28%
Hot Topic, Inc.	2009	2.94%	3.12%	2.92%
Huron Consulting Group, Inc.	2009	**6.08%**	4.01%	4.06%
Palomar Medical Technologies, Inc.	2009	3.94%	4.39%	3.94%
Perma-Fix Environmental Services, Inc.	2009	1.53%	4.69%	1.53%
Pharmasset, Inc.	2009	4.19%	5.76%	4.16%
Sequenom, Inc.	2009	**6.12%**	5.76%	6.04%
Ultratech Inc.	2009	2.26%	5.72%	1.74%
VIVUS, Inc.	2009	2.30%	5.76%	2.28%
American Axle & Manufacturing Holdings, Inc.	2008	**4.29%**	2.99%	2.44%
Arqule, Inc.	2008	3.72%	4.96%	3.71%
Cracker Barrel Old Country Store, Inc.	2008	3.10%	3.33%	2.31%
Emulex Corporation	2008	4.57%	4.80%	3.46%
FTI Consulting, Inc.	2008	**4.81%**	4.05%	4.05%
Iconix Brand Group, Inc.	2008	**3.42%**	3.33%	3.28%
IXYS Corp.[1]	2008	1.99%	5.59%	1.84%
NIC Inc.	2008	0.90%	6.11%	0.52%
Outdoor Channel Holdings, Inc.	2008	3.56%	5.93%	2.42%
Pain Therapeutics, Inc.	2008	4.36%	4.96%	4.36%
Radiant Systems, Inc.	2008	2.04%	6.11%	2.04%
Salesforce.com, Inc.	2008	5.48%	6.11%	4.84%
Sigma Designs, Inc.[1]	2008	4.54%	5.40%	4.54%
T-3 Energy Services Inc	2008	**4.29%**	3.09%	3.89%
The Cheesecake Factory, Inc.	2008	3.08%	3.33%	2.70%
Wilmington Trust Corp.	2008	1.62%	2.15%	1.53%
Arena Resources, Inc.	2007	1.19%	2.29%	1.19%

Company	Year	ISS Adjusted 3-Year Average Burn Rate	ISS Burn Rate Cap	Unadjusted 3-Year Average Burn Rate
Corporate Office Properties Trust, Inc.	2007	**2.40%**	2.23%	1.35%
Cracker Barrel Old Country Store, Inc.	2007	**4.17%**	3.41%	2.53%
Electro Scientific Industries, Inc.	2007	3.06%	4.70%	2.81%
Illumina, Inc.[1]	2007	**5.57%**	4.50%	5.56%
J2 Global Communications, Inc.	2007	2.02%	5.82%	1.88%
LTC Properties, Inc.	2007	0.34%	2.23%	0.20%
Microtune, Inc.	2007	4.44%	5.40%	4.38%
Penn National Gaming, Inc.	2007	3.00%	3.41%	2.82%
Resources Connection, Inc.	2007	**4.19%**	3.81%	4.17%
Tuesday Morning Corp.	2007	0.71%	3.05%	0.71%

[1] Company's proposal involved a plan with an evergreen provision.

A **bolded** 3-Year Average ISS Burn Rate signifies it exceeds the ISS Burn Rate Cap.

Repricing, Cash Buyouts, or Exchanges of Underwater Stock Options

Another risk factor for failure of an equity plan proposal relates to repricing, cash buyouts, or exchanges of underwater stock options or stock appreciation rights (SARs) without shareholder approval.

First, if a plan specifically permits repricing, cash buyouts, or exchanges of underwater stock options or SARs without shareholder approval, ISS will recommend *Against* the equity plan proposal.

Second, even if the plan is silent on repricing, cash buyouts, or exchanges without shareholder approval, if a company has engaged in any of those actions without shareholder approval, ISS will recommend *Against* the equity plan proposal and the company's incumbent directors. If a company had engaged in such actions without shareholder approval, it can avoid application of ISS's repricing policy by simply including a prohibition against repricing, cash buyouts, or exchanges of underwater stock options or SARs without shareholder approval in the proposed plan document.

Third, repricing, cash buyouts, or exchanges of underwater stock options or SARS is very likely to garner an *Against* vote from institutions that do not follow the ISS recommendation. Almost every institutional investor has a policy to vote *Against* plans that have the ability to reprice underwater awards without shareholder approval.

Of the 54 equity plan proposals that failed, ISS recommended *Against* one-third (33.3%) because they violated ISS's repricing policy. Unlike with ISS's burn rate policy, ISS cited a number of proposals for violating its repricing policy alone, which was still less than those that ISS cited for violating both its SVT cost and burn rate policies (7 vs. 11). Thus, it appears companies that found they would violate ISS's SVT cost policy were more likely to also violate ISS's repricing policy.

Pay for Performance

While ISS keeps revising and strengthening its pay-for-performance policy, it does not appear that shareholders have yet embraced it as a significant reason to oppose an equity plan proposal. Of the 54 equity plan proposals that failed, ISS only cited violation of its pay-for-performance policy for five proposals (9.3%).

Problematic Pay Practices

Similarly, ISS's problematic pay practices (previously referred to as "poor pay practices" by ISS prior to 2010) policy was cited for only seven of the 54 equity plan proposals that failed. However, ISS did revamp this policy for 2010, identifying "major" and "minor" problematic pay practices.[3] Having just a single "major" problematic pay practice could be enough to cause ISS to apply this policy and recommend *Against* an equity plan proposal and, possibly, the directors on the compensation committee, the CEO, or the entire board of directors. Additionally, if there are a sufficient number of "minor" problematic pay practices, ISS could also apply this policy.

While the problematic pay practices policy applies to equity plan proposals, it also applies to the election of directors. Generally, if the policy is violated, ISS can recommend *Against* all the compensation committee members that were on the committee when the problematic pay practice was adopted, but, if egregious enough, ISS could recommend *Against* the CEO as a director and/or the entire slate of directors.

ISS's problematic pay practices policy applies to management say-on-pay proposals, incumbent director elections (particularly members of the compensation committee), and equity plan proposals.

Liberal Change-in-Control Definition

The liberal CIC definition policy is relatively new for ISS, having been adopted for the 2009 proxy season. It has not yet been cited as the rationale for ISS's *Against* vote recommendation for an equity plan proposal that failed. Of the 54 equity plan proposals that failed, only one cited the liberal CIC definition policy, but this was done prior to the policy being effective, so ISS raised it in a cautionary manner. Many institutional investors that do not follow the ISS recommendation have similar policies on liberal CIC provisions.

Thus, the lesson with the liberal CIC definition policy is to review your plan to ensure it contains CIC control protection, the definition of CIC is written so consummation of the CIC deal is required.

[3] See Appendix for a list of ISS's "major" and "minor" problematic pay practices for the 2012 proxy season.

Other

Other reasons were cited by ISS only three times among the 54 equity plan proposals that failed. In one case, ISS recommended *Against* an equity plan proposal because it supported an alternative proposal seeking shareholder approval of an option exchange program for underwater stock options. In that case, ISS did note if a shareholder opposed the option exchange, it should support the equity plan proposal.

In another case, ISS cited an “other” reason in addition to an excessive SVT cost for the equity plan proposal. Specifically, ISS indicated that it opposed the proposal because the non-employee director plan had retainers that were heavily weighted towards equity, but vesting for director equity awards was only three years instead of five years.

So, there probably aren’t many lessons to be drawn from the “other” category except that if there are extenuating circumstances, be sure to vet them with individuals familiar with ISS policies and guidelines to ensure they won’t present an approval issue for the equity plan proposal.

Glass Lewis Recommendations

This paper has predominantly focused on ISS’ vote recommendations on equity plan proposals. ISS is the largest and most influential proxy advisory firm and its vote recommendations typically have the greatest impact on equity plan proposal voting. That said, the next most influential proxy advisory firm, Glass Lewis & Co., a distant second to ISS, can at times heavily influence the vote outcome. Glass Lewis typically has greater influence at certain mid-cap and small-cap companies. Companies should review their shareholder base as part of the preliminary ground work in requesting shareholder approval of an equity plan proposal so that they have at least a general understanding of how ISS and Glass Lewis will influence the shareholder voting in the proposal. In cases where ISS and Glass Lewis split in their recommendation, the positive recommendation of one can sometimes be used to offset the negative recommendation of the other. However, if both ISS and Glass Lewis recommend *Against* an equity plan proposal securing shareholder approval becomes a much more difficult undertaking.

CONCLUSION

If your dilution will be over 15 percent with your equity plan proposal, and you are not a small-cap company or in an industry that permits a higher level of dilution, you should be a little nervous and your level of discomfort should grow right along with the dilution as it exceeds that level. If your dilution would be above 20 percent, you should likely be quite concerned and perhaps seek out your top shareholders to ask their opinion about dilution levels before submitting an equity plan proposal to shareholders. To the extent your company's dilution would be out of step with its peers and/or industry group, you should be even more concerned. Also, consider your burn rate in relationship to the guidelines of your institutional shareholders. Much of the success or failure of an equity plan proposal depends on the composition of a company's shareholders, so a detailed analysis of the shareholder base must be undertaken. Some of the questions to be asked include:

- What is the level of influence of ISS among my shareholders?
- What are the voting guidelines of my non-ISS influenced shareholders?
- What is the "message" for my equity plan proposal?
- Can I leverage my retail shareholders to help the equity plan proposal pass?

As with most things, it is often easier to ask and receive when times are good, i.e., when the company stock has performed well and shareholders have experienced some gains. In recent proxy seasons that hasn't always been the case. But, it isn't an absolute necessity. Most institutional shareholders understand company equity programs are necessary in today's compensation arrangements. For many investors, as long as they have faith in management, and management can demonstrate it has been a responsible steward of the company, investors will support reasonable share requests. What is reasonable? It depends on the investor, but generally the answer will take into account the company's dilution level, how equity has been used in the past, and how long the shares requested might last (ideally, somewhere between three to five years for most investors).

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APPENDIX: PROBLEMATIC PAY PRACTICES

"Major"	"Minor"
• Repricing or replacing of underwater stock options/SARs without prior shareholder approval (including cash buyouts and voluntary surrender/subsequent regrant of underwater options) • Excessive perquisites or tax gross-ups, including any gross-ups related to a secular trust or restricted stock vesting • New or materially amended/extended agreements that provide for: — CIC payments exceeding 3x base salary and average/target/most recent bonus — CIC severance payments without involuntary job loss or substantial diminution of duties ("single" or "modified single" triggers) — CIC payments with excise tax gross-ups (including "modified" gross-ups)	• Excessive severance and/or CIC provisions — Payments upon an executive's termination in connection with performance failure — Liberal CIC definition in individual contracts or equity plans which could result in payments to executives without an actual CIC occurring • Overly generous perquisites which may include, but are not limited to, the following: — Personal use of corporate aircraft — Personal security system maintenance and/or installation — Car allowances — Executive life insurance • Internal pay disparity/excessive differential between CEO total pay and that of next highest-paid executive officer • Voluntary surrender of underwater stock options by executive officers — May be viewed as an indirect repricing/exchange program especially if those cancelled options are returned to the equity plan, as they can be regranted to executive officers at a lower exercise price, and/or executives subsequently receive unscheduled grants in the future • Egregious pension/SERP payouts, e.g., including additional years of service not actually worked • Other pay practices deemed problematic but not covered in any of the above categories