

MORROW & CO., LLC

Proxy Update

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Director Elections – Preparing for a Challenging 2009

The 2009 proxy season will present unprecedented challenges for public corporations on a wide range of issues, perhaps most prominently on director elections. Institutional investors and proxy advisory firms appear ready to target individual directors, committee members, and entire boards with an ever-growing list of compensation and governance triggers. In addition, the current economic climate is likely to erode support from individual shareholders, and broker discretionary voting is expected to provide less support for many director nominees as an increasing number of brokerage firms discontinue the discretionary vote of shares or shift to proportional voting. These changes will reduce turnout and magnify opposition at many annual meetings.

This environment places a premium on maintaining a thorough understanding of your ownership base, staying current on the issues that will attract board opposition and solidifying relationships with the voting decision-makers at major institutions. We believe issuers that make these efforts will be significantly more effective at minimizing withhold or against votes. We are prepared to provide guidance and strategic advice, as we work closely with our clients to ensure the successful election of all director nominees. We believe issuers that make these efforts will be significantly more effective at minimizing withhold or against votes.

Greater Exposure for Director Nominees

The RiskMetrics Group's ("RMG") updated 2009 voting guidelines may cause the firm to recommend more withhold or against votes on directors. For example, RMG's policy now includes a performance / governance test to identify boards of underperforming companies that are not sufficiently accountable and do not maintain proper oversight of management. RMG may withhold on governance committee members or entire boards if these companies have "problematic" governance structures such as poison pills, supermajority voting requirements, classified boards, or the inability of shareholders to call special meetings.

RMG also has expanded its list of "poor" pay practices to include the payment of excise tax gross-ups, excessively liberal change-in-control provisions, and tax reimbursements for any executive perks. Engaging in these and other "poor" pay practices may expose members of compensation committees to withhold or against recommendations from RMG (and possibly against recommendations on equity compensation plans).

Compensation committee members will be subject to a new and expanded RMG test that will determine if a pay-for-performance disconnect exists (i.e., has there been an increase in CEO compensation during a time of relative underperformance). In the past, RMG looked strictly at companies with negative total shareholder returns (comparing a company against its *six-digit* GICS group). In 2009, RMG will evaluate companies with one-year and three-year total shareholder returns that are in the bottom-half of an expanded industry category (based on a larger *four-digit* GICS group). In addition to the larger grouping being less relevant for most

companies, we believe the expansion increases the possibility of falling into the bottom-half for many issuers.

We expect the more common causes of withhold or against votes, such as board attendance, board independence and board responsiveness to shareholders, will still remain critical issues during the 2009 proxy season.

Changes to Discretionary Voting Will Negatively Impact Voting Returns

For several years, NYSE Rule 452 (which allows brokerage firms to vote in their discretion on certain “routine” items such as the election of directors) has been the target of activists’ ire. They view the election of directors as anything but “routine” and believe discretionary voting is a legal form of stuffing the ballot-box. While activists have been lobbying the SEC and NYSE to eliminate discretionary voting (either on all issues or only on director elections), brokerage firms have been taking action on their own.

In the last two years, a number of firms have taken it upon themselves to alter the way they cast votes on “routine” items. Some brokers have chosen not to issue any discretionary votes, instead only voting shares for which they receive actual instructions. Other brokerage firms have adopted a form of proportional voting for the retail segments of their holdings. In these cases, unvoted retail shares are voted in the same proportion as the instructed retail shares. Many of the largest retail houses have already adopted this approach, including: Charles Schwab, Goldman Sachs, Merrill Lynch and Morgan Stanley.

The list of proportionate voting brokers continues to grow; National Financial Services and First Southwest Company recently announced that they have adopted proportional voting for 2009, and several other firms have indicated that they are considering this switch prior to the 2009 proxy season – these firms include Wachovia Securities (formerly AG Edwards), JPMorgan Clearing (formerly Bear Stearns), Pershing, William Blair and Raymond James.

It is important to note that at firms where the proportional voting pertains only to the retail (i.e., individual) holders, the non-retail portions, such as hedge fund positions, are voted on a returns-only basis. Thus the proportional discretionary vote does not apply to the broker’s entire custodial position, reducing the potential overall vote.

This is compounded by the fact that many hedge funds utilize synthetic trading instruments like total return equity SWAPs to accumulate an economic interest in a company. In these instances, their prime brokers serve as the counter parties to the trade and may actually take possession of the stock and have the authority to vote the shares. However, the counter parties may not vote their shares as a matter of policy, especially in uncontested situations. As a result, the voting turnout is further reduced when custodial brokers utilize this form of proportional voting. Companies with significant hedge fund ownership may see the greatest decrease in turnout at these brokers.

The implications for director elections are potentially significant, since for many of our clients we expect brokerage firms with proportional discretionary voting will account for over 50% of all discretionary voting issued in 2009. Since angry or frustrated investors are more motivated to vote, proportional discretionary voting magnifies their impact on the outcome of director elections. This impact will be even more substantial for companies facing “just vote no” campaigns. When combined with the expectation of greater institutional opposition, changes in broker discretionary voting may make the difference between a majority vote in favor of a

director(s) or not. With the increasing number of companies that have adopted majority voting policies, this altered voting model could lead to failed elections, with some directors not getting the votes required for election.

Markets are Down and Individual Shareholders are Angry

Several factors lead us to believe that more individual investors will vote against directors in 2009 than ever before. The causes include: the downward economic spiral, enormous loss of shareholder value, corporate scandals, and increases in executive compensation despite negative stock price performance. Individual shareholders are frustrated, and we expect the election of directors to be the vehicle of choice for expressing this frustration

For several years, we have observed steady erosion in “automatic” support for directors from individual shareholders (in registered and street name). This erosion is likely to escalate this year. It will be important for companies to take this loss of support into account and prepare themselves for the fact that negative votes on directors will increase in 2009.

Despite all of the challenges, we continue to believe that companies can be successful in this environment. We strongly recommend that clients know their shareholder profiles intimately, maintain a clear understanding of governance and compensation issues, and engage in ongoing discussions with major investors. We are ready to work with you and to ensure that your board of directors is prepared to make informed and thoughtful decisions.

If you have any comments / questions or wish to discuss any of these issues, please call your Morrow & Co. representative.

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