Part One

The 21st Century Compensation Committee

COPYRIGHTED MATERIAL

Chapter 1

The Compensation Committee

One of the most important determinants of a successful corporate strategy is the quality of the compensation committee. The committee is charged with designing and implementing a compensation system that effectively rewards key players and encourages direct participation in the achievement of the organization's core business objectives.

Outstanding, well-integrated compensation strategy does not just happen. Rather, it is the product of the hard work of independent, experienced compensation committee members. The most effective pay strategies are simple in design, straightforward in application, and easy to communicate to management and investors. The pay program for the chief executive officer (CEO) should be in line with pay programs for the company's other executives and with its broad-based incentive programs. In other words, there should be no conflict in the achievement of objectives, and the potential rewards should be as meaningful to all participants as to the CEO.

The United States is unique in its vast number of high-earning entrepreneurs, entertainers, athletes, lawyers, consultants, Wall Street traders, bankers, analysts, investment managers, and other professionals. Yet, it is the pay levels of corporate executives, in particular CEOs, that stir the most heated debate and controversy. It is estimated that the bull market of the 1990s created over 10 million new millionaires whose wealth was derived almost solely from stock options. During this period, many CEOs made hundreds of millions in option gains and other compensation—often making as much as 400 times the earnings of the average workers in their companies. Beginning in late 2001, the business world changed dramatically. Now, with the public's and investors' direct focus on corporate governance and compensation philosophy, and anticipated changes in accounting rules affecting equity-based compensation, CEOs and other executives should not expect to sustain historic rates of wealth accumulation, absent substantial performance that is no longer linked solely to the price of the company's stock.

While the proxy statement compensation tables provide historical information and raw data about the company's remuneration of its top executive officers, the compensation committee's report in the proxy statement provides a window into the company's compensation philosophy and a means for investors to assess whether and how closely pay is related to performance. A thoughtfully prepared compensation committee report is good evidence of a well-functioning compensation committee that takes its work seriously.

Among the topics covered in this chapter are:

- Board and board committee structure
- Independence measures
- Compensation committee size
- Compensation committee charter
- Role of the compensation committee and its chair
- Duties and responsibilities
- Precepts for responsible performance
- Compensation benchmarking
- The importance of meeting minutes

BOARD STRUCTURE; THE FOCUS ON INDEPENDENCE

Much of the recent public scrutiny of corporate governance issues has focused on structural issues as they relate to corporate boards—questions related to independence from management; separation of the chair and CEO positions; issues related to the composition and function of board committees; and renewed efforts to create a framework in which outside directors can obtain impartial advice and analysis, free of undue influence from corporate management.

While it has always been desirable to have a healthy complement of outside directors on the board, new corporate governance rules adopted by the New York Stock Exchange (NYSE) and Nasdaq in 2003 require that a majority of a listed company's board consist of independent directors and, with limited exceptions, that such board appoint fully independent compensation, audit, and nominating/corporate governance committees. The new NYSE and Nasdaq rules also prescribe standards for determining the independence of individual directors, which, when layered over the director independence standards under Section 162(m) of the Internal Revenue Code (Code) and Rule 16b-3 of the Securities Exchange Act of 1934 (Exchange Act), make the nomination and selection of compensation committee members a challenging exercise.

COMPENSATION COMMITTEE COMPOSITION AND MULTIPLE INDEPENDENCE REQUIREMENTS

When selecting directors to serve on the compensation committee of a public company, the nominating committee should choose only those persons who meet all the relevant independence requirements that will permit the committee to fulfill its intended function. For example, a compensation committee member must be an "independent director," as defined under NYSE or Nasdaq rules, where applicable. In addition, a public company is well served to have a compensation committee consisting solely of two or more directors who meet (i) the definitional requirements of "outside director" under Code Section 162(m), and (ii) the definitional requirements of "non-employee director" under Rule 16b-3 of the Exchange Act. This often leads to a lowest common denominator approach of identifying director candidates who satisfy the requirements of all three definitions. Unfortunately, the three tests are not identical, and it is indeed possible to have a director who meets one or more independence tests but not another.

NYSE/Nasdaq Independence Tests

Under the 2003 NYSE listing rules, an independent director is defined as a director who has no material relationship with the company. Nasdaq defines independence as the absence of any relationship that would interfere with the exercise of independent judgment in carrying out the director's responsibilities. In both cases, the board has a responsibility to make an affirmative determination that no such relationships exist. The rules list specific conditions or relationships that will render a director nonindependent. These are summarized in Exhibit 5.1 in Chapter 5.

Rule 16b-3 Independence Test

Awards of stock options and other equity awards to directors and officers of a public company, generally referred to as "Section 16 insiders," are exempt from the short-swing profit provisions of Section 16 of the Exchange Act if such awards are made by a compensation committee consisting solely of two or more "non-employee directors" (as defined in Rule 16b-3 under the Exchange Act). In addition to such compensation committee approval, there are three alternative exemptions under Rule 16b-3: (i) such awards to Section 16 insiders can be preapproved by the full board of directors, (ii) the awards can be made subject to a six-month holding period (measured from the date of grant), or (iii) specific awards can be ratified by the shareholders (which alternative is, for obvious reasons, rarely taken).

Disadvantages of relying on full board approval for the Rule 16b-3 exemption are that (i) it is administratively awkward to single out awards to Section 16 insiders for special full board approval, and (ii) if the full board takes on that role, the

proxy statement report on executive compensation must be made over the names of all the directors. Therefore, prevalent practice is for the compensation committee to be staffed exclusively with directors who meet the Rule 16b-3 definition of "non-employee director," and to have the compensation committee approve all equity awards to Section 16 insiders.

To qualify as a "non-employee director" under Rule 16b-3, a director cannot (i) be a current officer or employee of the company or a parent or subsidiary of the company; (ii) receive more than $60,000 in compensation, directly or indirectly, from the company or a parent or subsidiary of the company for services rendered as a consultant or in any capacity other than as a director; or (iii) have a reportable transaction under Regulation S-K 404(a) or a reportable business relationship under Regulation S-K 404(b) of the Securities and Exchange Commission (SEC), as outlined in Exhibit 1.1.

IRC Section 162(m) Independence Test

For any performance-based compensation granted to a public company's CEO or its next four most highly compensated executive officers ("covered employees") to be excluded from the $1 million deduction limit of Code Section 162(m), such compensation must have been approved in advance by a compensation committee consisting solely of two or more "outside directors" (as defined under the Code Section 162(m) regulations). Full board approval of such compensation will not suffice for this purpose, unless all directors who do not qualify as outside directors abstain from voting. Therefore, prevalent practice is for the compensation committee to be staffed exclusively with directors who meet the Code Section 162(m) definition of "outside director," and to have such compensation committee approve all performance-based awards to executive officers and others who might reasonably be expected to become covered employees during the life of the award.

To qualify as an "outside director" under Code Section 162(m), a director (i) cannot be a current employee of the company, (ii) cannot be a former employee of the company who receives compensation for services in the current fiscal year (other than tax-qualified retirement plan benefits), (iii) cannot be a current or former officer of the company, and (iv) cannot receive remuneration from the company, directly or indirectly, in any capacity other than as a director. Exhibit 1.2 outlines the Code Section 162(m) independence test, including a summary of what constitutes "indirect" remuneration.

State Law Interested Director Test

To further complicate the analysis, the concept of independence is also applied in determining whether a director is "interested" in a particular transaction under consideration by the board or the committee. A director who meets all of the regulatory definitions of independence under the NYSE/Nasdaq rules, Code Section 162(m),

Exhibit 1.1 Regulation S-K 404(a) Transactions with Management and Others

When	Transaction occurred in last fiscal year or is currently proposed
Between Whom	(1) The company or its subsidiaries, and (2) the director or nominee or his or her immediate family member
Threshold Amount	$60,000
Nature of Interest	Direct or indirect material interest in the transaction or other entity
Exceptions	Instructions provide guidance as to whether an indirect interest is material

Regulation S-K 404(b) Certain Business Relationships

When	Now existing, during last fiscal year, or proposed in current fiscal year
Who	(1) The director or nominee for director, and (2) an entity that has a relationship with the company
Category 1 Relationship	*Other entity pays the company for property or services:* (a) The director or nominee is or has been in the last fiscal year either an executive officer, or 10% owner, of the other entity, and (b) Payment exceeds 5% of either (i) company's consolidated gross revenues for last fiscal year, or (ii) other entity's consolidated gross revenues for its last fiscal year.
Category 2 Relationship	*The company pays the other entity for property or services:* (a) The director or nominee is or has been in the last fiscal year either an executive officer, or 10% owner, of the other entity, and (b) Payment exceeds 5% of either (i) company's consolidated gross revenues for last fiscal year, or (ii) other entity's consolidated gross revenues for its last fiscal year.
Category 3 Relationship	*The company was indebted to the other entity at end of company's last fiscal year:* (a) The director or nominee is or has been in the last fiscal year either an executive officer, or 10% owner, of the other entity, and (b) Indebtedness exceeds 5% of company's total consolidated assets at the end of last fiscal year.
Category 4 Relationship	*The director is a member of the company's law firm:* The director or nominee is a member of or counsel to a law firm that the company has retained in the last fiscal year or proposes to retain in the current fiscal year.
Category 5 Relationship	*The director is a member of the company's investment banking firm:* The director or nominee is a partner or executive officer of an investment banking firm that has performed services for the company (other than as a syndicate member) in the last fiscal year or proposed for the current fiscal year.
Category 6 Relationship	Any other relationships substantially similar in nature and scope to those specifically identified.

Exhibit 1.2 Outside Director Requirements under Code §162(m) Regulations

Current Employee	The director cannot be a current employee of the publicly held company.
Former Employee	The director cannot be a former employee of the publicly held company who receives compensation for services in the current fiscal year (other than tax-qualified retirement plan benefits).
Officer	The director cannot be a current or former officer of the publicly held company.
Remuneration	The director cannot receive remuneration from the company, directly or indirectly, in any capacity other than as a director. See categories 1–4 for what constitutes “indirect” remuneration.
Category 1	If remuneration is paid directly to the director, he or she is disqualified. No *de minimis* exception.
Category 2	If remuneration is paid to an entity of which the director is a 50% or greater beneficial owner, he or she is disqualified. No *de minimis* exception.
Category 3	If remuneration (other than a *de minimis* amount) was paid in the last fiscal year to an entity in which the director beneficially owns between 5% and 50%, he or she is disqualified. See below for definition of a *de minimis* amount.
Category 4	If remuneration (other than *de minimis* amount) was paid in the last fiscal year to an entity by which the director is employed (or self-employed) other than as a director, he or she is disqualified. See below for definition of *de minimis* amount.
***De minimis* amount other than for personal services**	Payments not for personal services are *de minimis* if they did not exceed 5% of the gross revenue of the other entity for its last fiscal year ending with or within the company’s last fiscal year.
***De minimis* amount for personal services**	Payments for personal services are *de minimis* if they do not exceed $60,000.
Personal Services	Remuneration is for personal services if it (i) is paid to an entity for personal services consisting of legal, accounting, investment banking, or management consulting services (or similar services) and is not for services that are incidental to the purchase of goods or nonpersonal services; and (ii) the director performs significant services (whether or not as an employee) for the corporation, division, or similar organization (within the third-party entity) that actually provides the legal, accounting, investment banking, or management consulting services (or similar services) to the company, or more than 50% of the third-party entity’s gross revenues are derived from that corporation, division, subsidiary, or similar organization.

Exhibit 1.2 Continued

Former Officer Defined	A director is not precluded from being an outside director solely because he or she is a former officer of a corporation that previously was an affiliated corporation of the publicly held corporation. For example, a director of a parent corporation of an affiliated group is not precluded from being an outside director solely because that director is a former officer of an affiliated subsidiary that was spun off or liquidated. However, an outside director would cease to be an outside director if a corporation in which the director was previously an officer became an affiliated corporation of the publicly held corporation.

and Rule 16b-3 can still have a personal interest in a particular transaction that can interfere with his or her ability to render impartial judgment with respect to that transaction. This type of nonindependence will not render the director unsuitable to serve on the compensation committee, but he or she may need to be excused from voting on the particular matter. An example of this might be a situation in which the compensation committee is determining whether to hire a particular consulting firm to advise the committee with respect to a particular matter and one of the committee members has a relative at such consulting firm. This relationship would not necessarily bar the committee member from satisfying any of the regulatory definitions of independence (particularly if the amount of the consultant's fee is less than $60,000), but the director might have a personal interest in having the committee hire that consulting firm over another. In that case, the interested director should disclose the nature of his or her interest in the matter and abstain from voting on the hiring question. Once that consulting firm has been hired to represent the committee, the matter is over, and the originally interested director may resume active participation in the business of the committee.

Full Disclosure of Pertinent Information

The SEC's proxy rules require disclosure of relevant background information about each director that is intended to give shareholders an indication of the director's unique qualifications and any relationships or affiliations that might affect his or her judgment or independence. For example, disclosure is required regarding:

- All positions and offices the director holds with the company.
- Any arrangement or understanding between the director and any other person pursuant to which he or she is to be selected as a director or nominee.
- The nature of any family relationship (by blood, marriage, or adoption, not more remote than first cousin) between the director and any executive officer or other director.

- The director's business experience during the past five years.
- Any other public company directorships held by the director.
- The director's involvement in certain legal proceedings.
- Any standard arrangements pursuant to which directors are compensated, and any other arrangements pursuant to which a director was compensated during the company's last fiscal year for any service provided as a director.
- Any transaction, or series of similar transactions, occurring in the last year or currently proposed, to which the company or any of its affiliates is a party, in which the amount involved exceeds $60,000 and in which the director had, or will have, a direct or indirect material interest.
- Certain business relationships that currently exist, or existed during the last fiscal year, between the company and an entity affiliated with the director or nominee, and the nature of such director's or nominee's affiliation, the relationship between such entity and the company and the amount of the business done between the company and the entity during the company's last full fiscal year or proposed to be done during the company's current fiscal year.
- Any indebtedness of the director in excess of $60,000 to the company or its subsidiaries at any time in the last fiscal year.
- Any failure by the director to make a timely filing of any Section 16 report during the last fiscal year.
- Any director interlocking relationships.

Director Interlocks

As a reflection of the current insistence on unbiased, independent analysis in setting executive pay, there is a special sensitivity to so-called "director interlocks." A director interlock exists where any of the following relationships is in evidence:

- An executive officer of the company serves as a member of the compensation committee of another entity, one of whose executive officers serves on the compensation committee of the company.
- An executive officer of the company serves as a director of another entity, one of whose executive officers serves on the compensation committee of the company.
- An executive officer of the company serves as a member of the compensation committee of another entity, one of whose executive officers serves as a director of the company.
- NYSE/Nasdaq description—A director of the listed company is, or has a family member who is, employed as an executive officer of another entity where at any time during the last three years any executive officers of the listed company served on the compensation committee of such other entity.

While not prohibited as a legal matter, director interlocks are suspect due to the possibility that they could engender a "you-scratch-my-back, I'll-scratch-yours" influence or other *quid pro quo* situation affecting executive compensation decisions. For that reason, a director who has an interlock of the nature described under applicable NYSE or Nasdaq rules will not be deemed an independent director until three years after such interlocking employment relationship has terminated. During that time, he or she would not be eligible to serve on the compensation committee.

An interlocking relationship will be evident to the public. The SEC's rules for public companies require disclosure in the proxy statement, under the specific caption "Compensation Committee Interlocks and Insider Participation," of each person who served as a member of the compensation committee (or board committee performing equivalent functions) during the last fiscal year, indicating each committee member who is or was an employee or officer of the company, had a disclosable transaction with the company, or had an interlocking relationship.

COMPENSATION COMMITTEE SIZE

State law has little to say about the size of a board of directors, and even less about the size of its oversight committees such as the compensation committee. The Revised Model Business Corporation Act (Model Act), on which a majority of states base their corporation laws, provides that a board must consist of one or more individuals, with the number to be specified or fixed in accordance with the corporation's charter or bylaws. Under the Model Act, a company's charter or bylaws may fix a minimum and maximum number of directors and allow the actual number of directors within the range to be fixed or changed from time to time by the shareholders or the board. Delaware, which does not follow the Model Act but is the state of incorporation for many U.S. companies, has similar requirements for determining the size of the board.

Corporations should attempt to assemble a board that reflects a diversity of viewpoints and talents, but is not so large as to frustrate the accomplishment of business at meetings. Smaller boards (those with 12 or fewer members) may allow more free interchange among directors who might otherwise be reticent to express their views in a larger group. However, when considering the appropriate size for a public company board, it is important to include a sufficient number of independent directors to staff the audit, compensation, and nominating/corporate governance committees, each of which is now required by applicable rules to consist solely of independent directors.

Given the interplay of three separate independence requirements for compensation committee members, as discussed previously, it is unusual for a public company's compensation committee to have more than five members. A compensation committee of three to five members should provide an adequate forum for a useful exchange of ideas and healthy debate.

COMPENSATION COMMITTEE CHARTER

The compensation committee (whether it is called such or by some other name—e.g., the human resources committee) generally is established through a formal board resolution, in accordance with applicable state corporate law, the company's articles/certificate of incorporation, and/or the company's bylaws. In the past, some compensation committees had a written charter, while others did not. However, today most compensation committees have a written charter, largely due to recent changes in stock exchange listing rules. As discussed in more detail later, new rules at the NYSE require that both the audit committee and the compensation committee have a written charter, while the new Nasdaq rules only require that audit committees have a written charter. Nevertheless, compensation committees at most Nasdaq companies have or are in the process of adopting a written charter, in the spirit of good corporate governance. In addition, there may be other federal or state statutory or regulatory requirements for such a charter with respect to specific regulated industries.

Some companies use a short-form charter (often less than a page) that grants the compensation committee authority in very broad strokes. Others adopt a long-form charter that spells out the duties and responsibilities of the committee, the procedures to be followed, and a variety of other specifications and requirements (such as number of members, number of scheduled meetings per year, and so forth). While the long-form charter is often favored as providing an aura of good corporate governance practice, one drawback is that the details in the charter must in fact be followed. For example, if the charter provides that the committee shall meet at least once every quarter, then the committee must do so or be in violation. Another consequence of the long-form charter is the need for more frequent review and adjustment. Any adjustments must follow an appropriate amendment procedure and will require subsequent disclosure.

See Appendix D for a sample compensation committee charter and selected examples of a variety of compensation committee charters at NYSE and Nasdaq companies.

NYSE Compensation Committee Requirements

Under NYSE rules, the compensation committee must have a written charter that addresses the committee's purpose and responsibilities and requires an annual performance evaluation of the committee. The compensation committee of an NYSE listed company must, at a minimum, have direct responsibility to:

- Review and approve corporate goals and objectives relevant to CEO compensation, evaluate the CEO's performance in light of those goals and objectives, and, either as a committee or, if the board so directs, together with the other indepen-

dent directors, determine and approve the CEO's compensation level based on that evaluation. The committee is free to discuss CEO compensation with the board generally, as long as the committee shoulders these absolute responsibilities.

- Make recommendations to the board with respect to (i) compensation of the company's executive officers other than the CEO, (ii) incentive compensation plans, and (iii) equity-based plans.
- Produce a compensation committee report on executive compensation as required by the SEC to be included in the company's annual proxy statement or annual report on Form 10-K filed with the SEC.

The compensation committee charter should also address: (i) committee member qualifications, (ii) committee member appointment and removal, (iii) committee structure and operations (including authority to delegate to subcommittees), and (iv) committee reporting to the board.

If a compensation consultant is to assist in the evaluation of director, CEO, or senior executive compensation, the compensation committee charter should give that committee sole authority to retain and terminate the consulting firm, including sole authority to approve the firm's fees and other engagement terms.

Nasdaq Compensation Committee Requirements

Under Nasdaq rules, compensation of the CEO and all other executive officers of the company must be determined, or recommended to the board for determination, either by a majority of the independent directors, or a compensation committee comprised solely of independent directors. The CEO may not be present during voting or deliberations with respect to his or her own compensation.

Unlike the NYSE, Nasdaq rules do not specifically require the compensation committee to have and publish a charter. However, it is generally a matter of good corporate governance that a charter be established and followed. The first model compensation committee charter appearing in Appendix D is annotated to conform to both the NYSE and Nasdaq rules as currently in effect.

ROLE OF THE COMPENSATION COMMITTEE

Over time, the role of the compensation committee as a core oversight committee of the board has crystallized. As indicated previously, the new NYSE and Nasdaq corporate governance rules require all listed companies to have a compensation committee (or a committee having that function, regardless of the name) composed entirely of independent directors.

The tenets of sound corporate governance embodied in the NYSE and Nasdaq rules should be heeded by any company, whether public or private. In the shareholder-savvy climate of the 21st century, it would be hard to justify a nonindependent compensation committee in which the CEO is allowed to vote on or otherwise participate in decisions regarding his or her own compensation. The NYSE and Nasdaq rules set out minimum standards governing the deliberative process of the compensation committee. A good committee will not stop there. As discussed more fully in Chapter 5, a host of influential business and investor groups have published their own concepts of best practices for the compensation committee. While none is binding or has the force of law, and while one might not agree with all the views in each report, these best practice guidelines are a "must read" for every compensation committee member who undertakes seriously to consider the proper role of the committee.

The basic role of the compensation committee is twofold. First is to be the "owner" of the company's executive and director compensation philosophy and programs. Second is to provide the primary forum in which core compensation issues are fully and vigorously reviewed, analyzed, and acted upon (either by the committee itself or by way of recommendation to the full board or the independent directors as a group). The decisions and actions of the compensation committee may make the difference between mediocre and outstanding corporate performance.

The more defined role of the compensation committee varies from company to company, and is contingent on various factors such as ownership structure, concerns of shareholders (and perhaps stakeholders—as broadly defined), director capabilities, board values, market dynamics, the company's maturity and financial condition, and other intrinsic and extrinsic factors. The compensation committee, more than any other oversight committee, is charged with the all-important task of balancing the interests of shareholders with those of management. The essential conflict between these two interests is generally not over pay levels, but rather the relationship of pay to performance. Shareholders favor a compensation plan strongly tied to corporate performance, while managers have a natural tendency to prefer a compensation plan with maximum security.

Exhibit 1.3 is a matrix illustrating a typical division of responsibilities among the full board, the nominating committee, and the compensation committee relative to certain matters. Where the responsibilities overlap, it generally implies committee recommendation followed by board ratification.

ROLE OF THE COMPENSATION COMMITTEE CHAIR

The chair's role is to lead the committee and initiate its agenda. The chair of the compensation committee may be selected by the members of the compensation

Exhibit 1.3 Board/Compensation Committee Responsibility Matrix

	Approval/Review Required	
	Full Board	Committee
Corporate Organization		
• Certificate of Incorporation (adoption or amendment)	X	
• Corporate bylaws (adoption or amendment)	X	
• Stock: all authorization to issue or buy back shares	X	
Board Organization		
• Board membership qualification		Nominating
• Board committee memberships		Nominating
• New member selection		Nominating
Compensation Matters: ***Base Salary***		
• Salaries of CEO and executive officers		Compensation
Officer Employment Agreements		
• Severance agreements	X	Compensation
• Retention agreements	X	Compensation
• Change in control agreements	X	Compensation
Fringe Benefits		
• Establishment of new plans or amendments to existing plans	X	Compensation
Incentive Compensation		
• All arrangements for corporate officers		Compensation
• Approval of specific financial targets		Compensation
• Determination of payouts		Compensation
Long-term (Cash) Incentive Plans		
• Establishment of performance targets		Compensation
• Award sizing		Compensation
Stock Plans		
• Establishment of, or amendment to, equity compensation plans	X	Compensation
• Administration of stock plans		Compensation
• Grants of all stock plans		Compensation

committee, by the nominating committee, or as otherwise provided in the committee's charter. The responsibilities of the chair might appropriately include:

- To suggest the calendar and overall outline of the annual agenda for the committee
- To convene and prepare the agenda for regular and special meetings
- To preside over meetings of the committee, keeping the discussion orderly and focused, while encouraging questions, debate, and input from all members on each topic under discussion
- To provide leadership in developing the committee's compensation philosophy and policy
- To counsel collectively and individually with members of the committee and the other independent directors
- To interview, retain, and provide interface between the committee and outside experts, consultants, and advisors

DUTIES AND RESPONSIBILITIES OF THE COMPENSATION COMMITTEE

The fundamental task of the compensation committee is to establish the compensation philosophy of the company. Having done so, it should design programs to advance that philosophy. In almost all cases, this will require the advice of outside experts, to assure that specific performance metrics and performance goals are established that promote desired performance and that pay is in line with such performance.

The compensation committee should assume primary responsibility for the following general areas:

- Compensation philosophy and strategy
- Compensation of the CEO and other executive officers
- Compensation of nonexecutive officers (or the oversight of such compensation if delegated to others)
- Compensation of directors (this function is sometimes housed at the board level or with the governance committee)
- Management development and succession (this function is sometimes placed with the full board or the governance committee)
- Equity compensation plans
- Retirement plans, benefits, and perquisites (this function is sometimes shared with, or performed by, a separate benefits plan committee):
  - Qualified retirement plans, profit sharing, and savings plans

- Nonqualified plans such as supplemental executive retirement plans (SERPs), nonqualified deferred compensation, and pension restoration plans
- Welfare benefits, including medical, life insurance, accidental death and disability insurance
- Executive benefits such as supplemental medical coverage and supplemental life insurance
- Perquisites

- Contractual arrangements with management, including employment and severance agreements
- For public companies, preparation of the report to shareholders on executive compensation that is required by the SEC to be included in the company's annual proxy statement or annual report

The decision as to how far compensation committee oversight should be extended depends on various factors, including the corporate culture, strength of management, the size of the committee, members' time availability, the regulatory environment in which the company operates, and prior corporate performance in these areas.

Exhibit 1.4 contains a checklist covering typical duties of the compensation committee.

SIX PRECEPTS FOR RESPONSIBLE COMMITTEE PERFORMANCE

To execute its duties responsibly, the compensation committee must be able to efficiently synthesize highly technical information and apply sound business judgment. As the field of executive compensation becomes increasingly complex and more in the focus of public attention, the committee's job grows more and more challenging. Adherence to the following six precepts will pave the way to optimal performance by the committee:

1. Get organized
2. Get and stay informed
3. Keep an eye on the big picture
4. Return to reason
5. Consider the shareholders' perspective
6. Communicate effectively

1. Getting Organized

Set the agenda. As noted previously, many topics generally fall within the purview of the compensation committee. To make sure that all are considered in a timely and effective manner, the compensation committee chair should at the beginning

Exhibit 1.4 Checklist for the Compensation Committee

- Ensure disinterest and independence from management
- Retain and maintain direct access to outside experts/consultants
- Establish and periodically review/update compensation philosophy
- Establish a compensation strategy (including pay plans) consistent with overall compensation philosophy and corporate objectives
- Ensure that shareholder and corporate economic values are prime drivers of the executive pay program
- Be sensitive to external pressures
- Be mindful of controversial pay practices
- Balance fixed versus variable rewards
- Define equity participation strategy
- Understand and coordinate all elements of executive pay
- Assess the real dollar value/cost of executives' total pay packages
- Carefully select recognized industry index and/or an appropriate peer group for the performance group
- Compare pay programs with relevant peer group
- Link payments with performance goals
- Set goals for CEO, evaluation performance against such goals, and set CEO pay levels
- Draft compensation committee report for proxy statement. Use detailed, individualized disclosures—avoid boilerplate
- Prepare other disclosures, both required and more if necessary or appropriate

of the year prepare a schedule of meetings for the whole year, along with a tentative agenda for each meeting. To accommodate new topics arising over the ensuing months, specific agenda should be prepared and circulated before each meeting. An example of such an annual schedule, along with possible recurring agenda items, is shown in Exhibit 1.5.

Exhibit 1.5 Illustrative Compensation Committee Agenda

Event	Meeting Date	Recurring Agenda Items
End of calendar/ fiscal year in December	Late February	• Approve minutes of prior meeting • Review prior year operating results presented as required by bonus plan criteria • Evaluate performance of CEO for prior year, and review and approve recommended bonus plan payments • Review and approve recommendations related to current year participation in bonus plan

Exhibit 1.5 Continued

Event	Meeting Date	Recurring Agenda Items
		• Review and approve current year bonus plan targets for organization units and plan participants • Review and approve personal goals of CEO for current year • Review and discuss draft of compensation committee report for inclusion in proxy • Review executive compensation disclosures for inclusion in proxy • Review new plan proposals for inclusion in proxy
After annual shareholders' meeting and approval of stock-related plans	June/July or September/ October	• Approve minutes of prior meeting • Review and approve recommendations for annual equity grants • Review and approve mid-year promotions, new hires • Receive consultant's report on fringe benefits and benefit costs; competitive practices and recommended changes and costs • Receive annual management development and succession planning overview from CEO • Engage outside studies for various matters • Review performance of outside advisors
Late in year	November/early December	• Approve minutes of prior meeting • Review consultant's report on compensation levels and competitive pay practices • Review and approve recommended changes in salary structure and bonus plan provisions • Approve additions and removals from bonus plan participation • Review executive compensation budget, and approve annual salary increases for next year • New ideas session (planning session for new ideas, plans, and programs) • Discuss incentive measures for upcoming year • Annual review of executive severance plans • Review corporate compensation philosophy and pay strategy

Provide timely information. It is best to provide written materials to each committee member at least a week before each meeting so that he or she will have ample opportunity to review them in advance and will be able to come to the meeting fully prepared to ask pertinent questions and move the discussion forward. Such materials should include minutes of the prior meeting, and materials and information pertinent to the agenda for the current meeting—such as copies of any plans or agreements to be considered by the committee, reports and analysis from outside experts, internally prepared information relevant to the matter, and proposed resolutions.

Engage outside experts. Issues faced by compensation committees today involve sophisticated techniques and require a facile understanding of financial measures tax and accounting applications. The "level playing field" that will result from stock option expensing is causing widespread use of alternative types of equity compensation vehicles, many of which may be unfamiliar to compensation committee members. The array of choices alone can be bewildering. Moreover, the role of the committee itself is becoming imbued with an overlay of regulatory requirements and legal nuances, while trends in shareholder litigation underscore the importance of relying on the advice of outside experts. Delaware courts in the recent *Disney* and *Cendant* cases focused on the alleged failure of those compensation committees to seek expert advice in advance of important compensation decisions.

For these and other reasons, it is all but essential that the compensation committee look to competent outside compensation consultants and legal advisors. While it may be appropriate for the committee to engage its own legal counsel for special assignments, the relationship with the compensation consultant should be of an ongoing nature. It is axiomatic that it should be the committee, and not management, that interviews and hires outside experts. The allegiance of such experts should be to the committee, and ultimately to the company, rather than to management.

Establish a meaningful CEO evaluation program. The compensation committee should create and adhere to an effective CEO evaluation program. NYSE and Nasdaq corporate governance rules require the compensation committee to review the CEO's performance on an annual basis, but this should be done regardless of any regulatory requirement. Such an evaluation is essential for the proxy statement compensation committee report, and provides a basis for determining whether the company's executive incentive compensation programs are achieving intended results. Chapter 3 addresses the CEO evaluation process.

Establish annual compensation committee (and perhaps board) evaluation programs. Recent NYSE corporate governance rules require an annual self-performance evaluation by the compensation committee. If board compensation is within the purview of the compensation committee rather than the nominating/governance committee, it may also make sense for the compensation committee to implement the board evaluation program. The program should include feedback

solicited from other directors, the CEO, other senior executives, and other interested parties. See Exhibit 1.6 for a sample board evaluation form.

2. Getting and Staying Informed

Understand the context. The committee cannot make valid compensation decisions in a vacuum. Even where the committee does not have direct oversight or responsibility for all aspects of compensation and benefits, it is imperative that the

Exhibit 1.6 Sample Form for Board Evaluation

Rate the following statements in relation to our board of directors

Topic	Description	Rating*
1.	The board knows and understands the company's beliefs, values, philosophy, mission, strategic plan, and business plan, and reflects this understanding on key issues throughout the year.	
2.	The board has and follows procedures for effective meetings.	
3.	Board meetings are conducted in a manner that ensures open communication, meaningful participation, and timely resolution of issues.	
4.	Board members receive timely materials for consideration prior to meetings.	
5.	Board members receive accurate minutes.	
6.	The board reviews and adopts annual capital and operating budgets.	
7.	The board monitors cash flow, profitability, net revenue and expenses, productivity, and other financially driven indicators to ensure the company performs as expected.	
8.	The board monitors company performance with industry comparative data.	
9.	Board members stay abreast of issues and trends affecting the company, and use this information to assess and guide the company's performance not just year to year, but in the long term.	
10.	Board members comprehend and respect the difference between the board's policy-making role and the CEO's management role.	
11.	The board acts to help the CEO by setting clear policy.	
12.	Board goals, expectations, and concerns are honestly communicated with the CEO.	

*Rating 1 to 5, with 1 for "not performing" to 5 for "outstanding"

committee have an understanding of how all pieces of the puzzle fit together. The committee should have access to information necessary to calculate the value of an executive's total compensation arrangement at any given time. For example, if the committee is considering one element of pay for the CEO, such as a long-term equity award, it must be able to do so in the context of the CEO's total pay, including all forms of compensation and benefits (such as base salary, short-term incentive opportunity, qualified and nonqualified deferred compensation, SERPs, perquisites, severance arrangements, and other previously granted long-term incentives), to ensure that the total compensation is reasonable and not excessive.

Naturally, not all elements of pay will be considered at a single committee meeting, and not all information before the committee at a given time will be presented with equal detail or emphasis. However, as baseline contextual information, the committee should insist on regularly being provided with the senior executives' total compensation tallies—perhaps in the form of a simple spreadsheet showing each element of pay and benefits, a brief summary of how each pay program operates, and an estimate of current rates, benefit levels, or balances.

Understand each element of the compensation program. The compensation committee, not management or the human resources department, is the "owner" of the company's executive compensation and employment plans, programs, and arrangements. As such, it is the compensation committee's duty to thoroughly understand all compensation programs, both simple and complex.

There is no one "correct" way to conduct this review, as long as it results in a full and thorough examination of each program. Generally, this review will involve management (including the human resources department), the company's auditors, and the committee's independent advisors. Only when the committee has its arms around all aspects of each program can it make informed and appropriate decisions in implementing (and perhaps restructuring) the overall compensation strategy.

Regularly review and quantify the impact of change-in-control provisions in all compensation plans and programs. Change-in-control (CIC) arrangements have become almost universal for senior executives in the largest public companies. At some companies, CIC agreements or policies extend protections deeper into employee ranks, and in some cases, cover all employees. The committee must keep sight of the estimated aggregate cost of all such CIC protections, including tax gross-ups and lost deductions, under various circumstances. Because circumstances change and compensation programs can dramatically affect the cost of CIC arrangements in not-so-obvious ways, this exercise should be undertaken on a regular basis to guard against surprises if and when an actual CIC situation arises. In assessing the potential cost, the committee should consider that aggregate CIC payments of 1% to 3% of the transaction amount are generally within standard practice.

3. Keeping an Eye on the Big Picture

Compensation plans and programs should be consistent with the achievement of corporate strategy. This is especially true with incentive-based compensation. It makes little sense for the compensation programs to be motivating executives to achieve goals that do not enhance overall corporate objectives.

The committee must take an active hand in the process. For example, with the aid of management and outside advisors, each member of the committee should learn and understand the financial measures that are most relevant to the company's success and design incentive programs on the basis of those measures. The committee should understand how any year-end financial reporting adjustments (or other events) might affect such measures and thereby affect compensation based on those measures. Where feasible, performance compensation programs should be designed to minimize the possibility of manipulation to achieve certain results—not on the assumption that management would do so, but more as evidence of a sound and reliable program.

The compensation committee should be prepared to explain to investors in its annual report on executive compensation how the short-term and long-term incentive programs for executive officers relate specifically to and complement the company's overall strategy. Moreover, the committee should be thoughtful in setting and explaining goals for incentive compensation. For example, setting "stretch" or very demanding goals and being prepared to pay commensurate with achieving this level of performance, can be an effective driver of performance.

4. Returning to Reason

There is no denying that executive compensation in the 1990s soared to unsustainable levels. Fueled by the seemingly endless bull market, the investing public's "irrational exuberance" (as dubbed by Alan Greenspan as early as 1996) and perhaps even unintentionally by the then-prevailing benchmarking practices of compensation consultants in which all executives were slated for above-average pay levels, executive compensation simply got out of hand. In the sobering post-scandal environment of the new century, boards and management alike recognize that something dramatic must be done to restore investor confidence and return compensation to sensible, sustainable levels. If the private sector cannot be disciplined and effective in achieving this, it is likely that the nose of Congress will once again creep under the tent.

Outside experts and advisors cannot be expected to right the ship—that requires the attention, support, and serious direction of the compensation committee. Consultants and advisors should be given free reign and encouragement to give an honest review and assessment of the company's pay practices and to speak up when changes are in order. The compensation committee must then be prepared to make

hard decisions or negotiate with management if cutbacks on existing compensation are recommended in one area or another. Evidence of real negotiations with management can be of evidentiary importance in future shareholder litigation.

All this is not to say that executive pay is evil or unnecessary. It is, of course, still true that competitive compensation is needed to attract and retain the best executive talent. The compensation committee will continue to need to understand the "market" for executive compensation, both in form and levels of pay. Independent compensation specialists are best equipped to provide this information. However, the common practice of setting pay based on benchmarking for comparable positions gleaned from survey data is one of the main culprits for runaway compensation in the 1990s. This is because so many companies targeted executive pay at the 75th percentile of the selected peer group. It is easy to see, in hindsight, that this annual ratcheting effect—where this year's 75th percentile becomes the next year's 50th percentile—led to unrealistically high competitive data. Moreover, there is considerable room for manipulation of such studies, by cherry picking the peer companies, for example, to include those that recently experienced aberrational strong performance, those that emphasize one element of pay over others, or those that are not appropriate peers of the company based on revenue, market cap, or other factors. While the committee need not turn away from considering objective outside data as a legitimate measure of competitive practice, it can safeguard the process by making sure its consultants understand the committee's expectation of candor and objectivity, and by asking the right questions about how and why the data were selected. The mechanical process of compensation benchmarking is discussed later in this chapter.

5. Considering the Shareholders' Perspective

The compensation committee must consistently ask the question, "is this in the shareholders' best interests and how will shareholders view it?" In today's business environment, shareholders are taking a greater interest than ever before in matters of executive compensation. While this does not change the duty or allegiance of the committee, it does provide a useful focus to its deliberations.

Shareholder value is paramount. In general, executive compensation should be accretive to shareholder value. Existing and new programs should be considered by the compensation committee in this context. The committee should analyze each compensation program with a view to its potential effects on financial results and shareholder dilution, and whether such effects can be managed or mitigated. For example, in the case of an equity-based compensation plan, the source of shares to pay participants (i.e., newly issued shares or repurchases in the market) can affect the dilution analysis.

Understand and consider institutional investor concerns. Institutional investors are making their voices heard loud and clear, aided by a number of factors, including new NYSE and Nasdaq rules that require shareholder approval for all new or materially modified equity compensation plans, new rules that prohibit brokers from voting street-name shares on compensation plan proposals without the express direction of the beneficial owners, and the increasingly high approval rate of shareholder proposals in recent proxy seasons. Shareholder activism has matured considerably from its roots in the 1970s. Independent research firms such as Investor Responsibility Research Center glean, organize, and make available information on corporate governance and social responsibility issues affecting investors. IRRC does not advocate on any side of the issues it covers. A host of institutional investor advisory groups, such as Institutional Shareholder Services, Glass-Lewis & Co., and The Council of Institutional Investors, as well as large investor pension funds such as TIAA-CREF, CalPERs, SWIB, and NYCERS, take a more confrontational stance on issues. Most have formulated complex models for assessing the potential dilution and "value transfer" of proposed compensation plans. Together or individually, these groups make possible powerful voting and economic blocks that cannot be ignored.

The compensation committee should be proactive in anticipating institutional investor concerns. Corporate governance issues, such as the independence of directors, organization of the board, incentive plans and programs, CEO selection and succession, employment agreements, executive stock ownership, insider trading actions, compensation levels, and other related issues are fair game for shareholder comment. It is usually productive to seek the input of the company's largest institutional investors on compensation proposals well in advance of putting them up for shareholder vote. Often, it is possible to adjust proposed plan provisions in a way that will make the difference in the plan being approved or voted down.

6. Communicating Effectively

Take control of the compensation committee report. The committee's report on executive compensation that appears in the annual proxy statement provides the best window into the work of the committee. The amount of candor, care, and detail that goes into that report speaks volumes about how seriously the committee takes its role and responsibility. The preparation of this report should not be relegated to management, the compensation consultant, or legal counsel. Rather, it should reflect the independent and thoughtful analysis of the committee, even if others participate in the drafting. Boilerplate language is not a substitute for the actual voice of the committee, nor should the report say the same thing every year—assuming that new thought and analysis takes place each year, as it should. A

straightforward and thorough explanation of the committee's actions and philosophy is critical to a meaningful report. Remember that the report goes over the names of the individual committee members, which is meant to assure that they personally stand behind its content.

See Appendix E for sample compensation committee reports taken from several 2004 proxy statements.

Prepare for increased disclosure and accountability. It has been well over a decade since the SEC's 1992 overhaul of the executive compensation disclosure rules. When the SEC revisits these rules, as it surely will before long, we can expect to see more tabular disclosure of common compensation programs, such as deferred compensation, SERPs, and life insurance programs, as well as disclosure rules that more closely fit the array of equity-based incentive vehicles that are finding their way into compensation plans as replacements for traditional stock options and restricted stock awards. The compensation committee can and should get out in front of that wave by collecting information now about its current programs and policies, considering whether and how all elements work together for a cohesive whole, and thinking about how to effectively communicate this to shareholders. In fact, there is no need to wait until SEC rules require specific disclosures. Effective communication is always timely and can go a long way to building investor confidence that the company's compensation strategy is in good hands.

COMPENSATION BENCHMARKING

Compensation committees are constantly examining whether the compensation levels of the top executives are reasonable and adequate. This is done for two reasons. First is to ensure that the pay levels are competitive, because if they are not (otherwise referred to as "below market"), another company may try to "raid" the executive talent pool. Second is to ensure that the compensation levels are neither too high nor too disproportionate (i.e., there is reasonable balance between salary, annual bonus, long-term incentives, pension, and so on).

This examination generally entails two processes. First is to collect and review recent and reputable surveys (usually published by compensation consulting or accounting firms). These surveys must be carefully reviewed to determine the methodology used and the quality of the data. For example, a survey might say that the median salary of CEOs in the biotechnology industry is $400,000; however, upon closer review, it may be discovered that only three companies were included, and that one of the companies has a founder CEO who receives a nominal salary. Accordingly, these surveys are helpful but cannot—in and of themselves—be used to set executive compensation levels without full and careful analysis.

The second process is to prepare a benchmarking or comparison study. This can be done in-house, but most companies prefer to use outside advisors. The most

important aspect of these studies is to construct a peer group of companies that both the compensation committee and management agree represents "market." In addition, there should be a minimum of 10 peer companies. Generally, 15 to 30 companies would be preferred to ensure that any anomaly (known as an "outlier" or a "red circle") would not significantly impair the overall results.

Peer companies generally are selected based on similarities to the subject company in terms of revenues, market capitalization, and/or industry, oftentimes using Standard Industrial Classification (SIC) codes that are the same as or similar to the subject company. Sometimes, other aspects are considered, such as geography, company age, financial performance, and so forth. No matter what and how many characteristics are used to construct the peer group, the key is for all parties to agree that the peer group is representative of an appropriate "market."

After the peer group is finalized, the next step is to collect and collate executive compensation data, either from private databases or culled from publicly filed documents, such as proxy statements and Form 10-Ks. Of course, each data point must be reviewed to ensure that it is correct. For example, some benchmarking studies will mingle different fiscal years. Other benchmarking studies may mechanically cull data from a proxy statement without any analysis, and thus could, for example, use an "annual salary" amount that actually is for a partial year. Other benchmarking studies may apply inconsistent valuation methodologies (such as valuation of stock options or other long-term incentive awards). In addition, more and more benchmarking studies are including performance analysis of each peer company. This is then used to determine whether the compensation level should be set at, below, or above the peer group's median level. For example, if the subject company is performing well below the median of the peer group, then arguably the compensation levels should also be below the median of the peer group.

Finally, after all the data are collected, reviewed, and otherwise "scrubbed," it is placed into a model that typically shows quartiles and what percentile levels apply to the company's existing executives or candidates. An example of such a model is shown in Exhibit 1.7.

These models also typically show ratios, such as between target annual bonus and salary, long-term incentives (LTI) and salary, and LTI and total compensation. In addition, some companies use ratios to set executive compensation levels below the CEO (e.g., the COO's salary level is set at 75% of the CEO's salary level).

While many companies have used these benchmarking studies as a rigid guide to setting executive compensation, there is a trend to apply both an objective and subjective analysis of the data. In other words, the data are first quantitatively reviewed, and then qualitatively reviewed. The reason for this is that each company has its own particular set of facts and circumstances, and square pegs should not be forced into round holes. For example, assume a company wants to pay its CEO at "market median," that the median CEO salary of the peer group is determined to be $500,000, and the salary of the subject company's CEO is $650,000.

Exhibit 1.7 CEO Benchmarking Study Template

Company	CEO	Salary	Target Bonus	Total Actual Bonus	Cash Comp	Restricted Stock	Stock Options	Other LTI	Total LTI	Other Comp	Total Comp
# 1											
# 2											
# 3											
...											
# 20											
Subject Company											
Minimum											
25th Percentile											
50th Percentile											
75th Percentile											
Maximum											
Average											

The compensation committee, however, when it hired the CEO, agreed to the $650,000 salary level because that was the CEO's salary level at the previous employer. Accordingly, the salary level will be in the upper quartile, and the compensation committee will most likely need to adjust other components of this CEO's compensation (but not the salary) to bring it within "market median."

THE IMPORTANCE OF COMPENSATION COMMITTEE MEETING MINUTES

Today's heightened focus on corporate governance in general, and executive compensation in particular, justifies a close review of the processes of the compensation committee, and its documentation of the same. It has always been customary corporate practice to keep minutes of committee meetings. However, it is important to recognize that minutes, which are easily attainable by shareholders, are as important in what they don't say as what they do.

Historically, many companies have taken the view that perfunctory, bare-bones minutes were adequate and even preferred—a means of satisfying minimum corporate procedural requirements without airing dirty laundry in the form of dissenting opinions or serious debate that might suggest lack of unanimity or weakness of resolve. However, recent shareholder litigation and apparent trends in judicial review, as discussed more fully in Chapter 5, suggest that the better approach favors thoughtful minutes that reflect in detail the ultimate action taken, the discussion of each topic, the time devoted to the discussion, the alternatives reviewed, the consideration of relevant materials and outside advice, and the rationale for each decision reached. Two recent Delaware court cases illustrate how the quality of minutes can make a difference very early in the litigation process.

In 2003, the Delaware Chancery Court refused to dismiss a complaint by shareholders in *In re Walt Disney Co. Derivative Litigation,* 825 A.2d 275 (Del Ch. 2003), alleging that Disney's directors breached their fiduciary duties when they approved an employment agreement with its president, Michael Ovitz, which ultimately resulted in an award to him allegedly exceeding $140 million after barely one year of employment. The court focused heavily on what was reflected in the minutes of the compensation committee, from which it appeared that (i) no draft employment agreement was presented to the compensation committee for review before the meeting; (ii) the committee received only a summary of the employment agreement and no questions were asked about the agreement; (iii) no expert consultant was present to advise the compensation committee; (iv) the compensation committee met for less than an hour and spent most of its time on two other topics, including the compensation of one director for helping secure Ovitz's employment; (v) no time was taken to review the documents for approval; and (vi) the committee approved the hiring in principle but directed Mr. Eisner, Ovitz's close friend, to carry out the

negotiations with regard to certain still unresolved and significant details. Referring to the board meeting that followed the compensation committee meeting, the court further noted that less than 2 of 15 pages of minutes were devoted to discussions of hiring the new president and that, so far as such minutes reflected, no presentations were made to the board regarding the terms of the draft agreement, no questions were raised, and no expert consultant was present to give advice.

The *Disney* court concluded that the alleged facts, if true, could support a determination that the defendant directors' action went beyond a mere breach of the duty of care to amount to a lack of good faith, such that their action would not be protected by the business judgment rule or by the company's director exculpation provision in its charter. If so, the directors could be held personally liable and unindemnifiable.

Also to the point is the April 2004 settlement of shareholder litigation against Cendant Corporation. The complaint alleged the directors breached their fiduciary duties in approving an amendment to the CEO's employment agreement that would have provided, among other things, an uncapped annual bonus stated as a percentage of the company's pretax earnings, $100 million of life insurance for life, and severance benefits that could have exceeded $140 million. According to the complaint, the minutes of the compensation committee reflected (i) no analysis of the potential cost to Cendant of the new agreement, (ii) no discussion of the committee's deliberation on various aspects of the proposed changes to the agreement, (iii) no advice from outside advisors, such as compensation experts or independent legal advisors, (iv) no questions raised about the financial consequences to the company under various severance scenarios, and (v) no involvement by any member of the compensation committee in the negotiation of the agreement. Even if the directors did in fact exercise more care and deliberation than alleged, the quick settlement of this lawsuit (the month after it was filed) might indicate the defendants' recognition of the damning potential of scant minutes on their ability to establish adequate proof to the contrary.

The lesson from these cases and others sure to come is this: Adherence to fiduciary duties is an absolute requirement and keeping minutes that reflect the proper amount of attention, deliberation, and consideration of compensation decisions can be of pivotal evidentiary value in shielding directors from personal liability.

Accordingly, compensation committee meeting minutes should reflect:

- Each discussion topic and the approximate time that the matter was considered
- Whether outside advisors were present or consulted, and the extent of their involvement
- The committee's consideration of any cost analyses for specific proposals, such as financial modeling of employment and severance contracts under various scenarios

- Whether questions were asked, about what, and by whom
- Due consideration by the committee of the reasonableness of the particular element of pay being voted on, when viewed in context with the executive's overall compensation package

CALL TO ACTION

The work of the modern compensation committee is not "business as usual." To take a lofty view (and to borrow the words of former SEC chairman and "MCI Corporate Monitor" Richard Breeden in his well-publicized report to the board of directors of MCI Corporation), theirs is the job of restoring trust in corporate America, by reversing the compensation excesses of the late 20th century that have so evoked the public's ire. On a more pedestrian level, to the extent that compensation committees across the country are in fact successful in reestablishing realistic and effective compensation practices through their own disciplined approaches, Congress may be persuaded to stay out of the mix. Ultimately, the compensation committee of the 21st century has the opportunity now to shape its own future.