

ViewPoints

Fall 2011: going back to basics

On October 3–4, 2011, the Compensation Committee Leadership Network (CCLN) convened in New York, NY, for its 15th meeting. Over the course of the two-day agenda, members discussed a number of topics, including the art of peer groups and the role of an effective compensation committee chair.

William B. Chandler III, partner at Wilson Sonsini Goodrich & Rosati and former chancellor of the Delaware Chancery Court, joined members over dinner on October 3 to discuss the Delaware Chancery Court. On October 4, H. Rodgin (Rodge) Cohen, senior chairman and partner at Sullivan Cromwell, LLP, joined members to discuss director liability.

The following members participated in the discussion:¹

- John Anderson, Meridian Compensation Partners
- Dick Notebaert, AON Corporation
- Jill Considine, Interpublic Group
- Michael Powers, Meridian Compensation Partners
- Don Felsing, Northrop Grumman
- Steve Sanger, Wells Fargo
- Linda Fayne Levinson, NCR and Western Union
- Dan Schulman, Symantec
- Marge Magner, Accenture
- Kelvin Westbrook, Archer Daniels Midland

The following members took part in pre-meeting discussions:

- Thomas J. Donohue, Union Pacific Corporation
- Laurie Siegel, CenturyLink
- David R. Goode, Caterpillar and Delta Air Lines
- William D. Smithburg, Corning
- Marshall O. Larsen, Lowe's Companies
- Anne Stevens, Lockheed Martin
- Robert J. Lawless, Constellation Energy Group

Executive summary

The fall CCLN meeting provided an opportunity for members to go back to basics, focusing on topics such as peer groups and the role of an effective compensation committee chair. They also enjoyed conversations with two guests that focused on issues that affect nearly all corporate

¹ The compensation committee chairs are identified by their board membership. John Anderson and Michael Powers participated in their capacity as compensation experts. *ViewPoints* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments made during the meetings are not attributed to individuals or corporations. CCLN member quotes appear in italics. Guest quotes are attributed and not italicized.

directors – the Delaware Chancery Court and director liability. Each of these distinct discussions is summarized below and discussed in more detail on the following pages:

▪ **The art of peer groups** (*page 2*)

The peer group is a familiar compensation tool that enables compensation committees to compare their compensation practices and performance to that of their peers and competitors. Members appreciate the fundamental comparative value these groups provide, but also acknowledge they are rife with limitations and prone to criticism. Members considered the challenges they encounter in designing, maintaining, and using peer groups and the practices their committees employ to overcome the common challenges. Ultimately, many members agreed with one who said, *“Peer groups are more of an art than a science.”*

▪ **The effective compensation committee chair** (*page 7*)

In light of new regulation, compensation committees face heavier workloads, increasing complexity, and frequent scrutiny. As a result, the compensation committee chair’s role has become more time consuming and demanding. CCLN members discussed practices they have adopted to promote effective committee meetings – such as pre-meeting discussions and regular executive sessions – and ongoing practices they employ to ensure the full board is aware of important compensation decisions.

▪ **Discussions with William B. Chandler III and H. Rodgin Cohen** (*page 11*)

Members engaged in a discussion with Mr. Chandler about the role of the Delaware Courts, some of his key rulings, and the role of the director today in an environment of increasingly short-term shareholders. Members also met with Mr. Cohen to discuss director liability in the context of derivative lawsuits that followed failed say-on-pay votes, investor communications, and activist attempts to access the board.

The art of peer groups

Peer groups are one of many inputs that compensation committees use to arrive at thoughtful pay decisions. They provide meaningful comparisons to the compensation plans and performance of organizations with which the company may compete for talent, resources, market share, or investment. Comparison data helps companies distinguish market movement from company performance, aligns compensation with the job market, and enables firms to attract and retain top talent.

However, meaningful peer groups are often difficult to construct, and they pose significant challenges to compensation committees. Because they are *“invariably imperfect,”* CCLN members emphasized the importance of using peer groups as a reference tool rather than a device that directly influences compensation decisions. One member said, *“As long as you don’t let peer groups drive compensation in a formulaic way, they are a good reference tool that the committee can use to understand their compensation plan and performance in the context of their peers.”*

CCLN members typically use peer groups in two ways: as *“a tool to measure performance”* and as *“a reference point for pay decisions.”* One member said, *“Peer groups help you define your performance relative to competitors and they show you if you are paying in line with the market. This gives you a basis for saying we are in the 25th, 50th, or 75th quartile.”* Because some companies use peer groups in two distinct ways, they construct and use multiple peer groups. One member explained, *“We build two peer groups – one for talent and one for performance.”* Conversely, another said, *“It is too complicated to create specialized situations, so we took a practical approach. It is easier to have one peer group.”*

The level of compensation committee involvement in designing the peer group may vary, but CCLN members noted that compensation committees *“should own the process.”* Members acknowledged this has not always been the case: *“In days past, the CEO might have come in with the group of companies he thought should be in the peer group. That doesn’t happen now. The compensation committee is in charge of designing the group.”*

Members noted that the committee can productively engage the compensation consultant to do the *“leg work”* of creating the groups. One member said, *“The compensation consultant works for the compensation committee. They will come up with a logical starting point for the group. We will look at that and then go on to discuss why it might make sense for certain companies to be included or excluded.”*

As members discussed their committees’ processes for creating, changing, and using peer groups, five key challenges emerged, as well as practices committees have adopted to address them.

Many companies lack significant numbers of obvious or natural peers

How companies determine who to include in a peer group is *“very dependent on industry and company.”* While some companies have a number of obvious peers and direct competitors, others have unique business models, no clear peers, or compete primarily with private companies. Companies that have no natural peer group tend to use other criteria for creating a group of comparable companies. One member commented, *“A good peer group is like a composite, incorporating all of the factors you think are important.”*

Members described some of the criteria companies consider in creating their peer groups:

- **Size.** *“We screen for companies that are similar in size by revenue.”* Compensation experts note that size is an important element when determining compensation: *“For example, if your company size approximates the 25th peer percentile, perhaps pay should be targeted at approximately the 25th percentile of this particular group.”*²
- **Industry.** Companies within the same industry are an important comparable because they *“compete for market share”* and are *“subject to similar industry-wide market movements.”*

² Aubrey Bout and Brian Lane, [“Smart Compensation: Developing & Using Peer Groups.”](#) *Workspan*, April 2011, 29.

- **Talent.** *“We include companies that we compete with for talent.” It is important to “measure your pay against companies that might want to steal your CEO away.”*
- **Complexity.** Large, complex companies will look for comparison companies that *“are similarly complex.”* If a company has a significant global aspect, it will seek companies that have *“similarly international operations or customer bases.”*
- **Alternative investments.** *“We consider where shareholders could otherwise invest their money and include some of those companies.”*
- **Peers’ peers.** *“We look at all of the peers of our peers. We would include a company if it appeared in at least two of our peers’ peer groups.”*
- **High performers.** *“We include some of the best performers out there – the exceptionally well-run companies in tangential industries.”*

Importantly, members noted that compensation consultant data is a major factor in selecting companies for a peer group. One member said, *“The [starting] pool of companies is dependent on the data that the compensation consultant has ... If a company stops participating in [the compensation consultant’s] data, they will not be considered.”*

Once a group of peers is defined, some companies will strategically weight the peer companies based on their relevance; perhaps not surprisingly, this is typically not a formal process. One member explained, *“We figure out which metrics or companies are the most relevant. We don’t apply a scientific weighting, but we do apply some judgment about which ones are more important.”* As an example, one member said, *“We have three major peers – these are the companies that we compete with directly – and we also have a number of other companies that we consider peers. When we look at that group, we pay more attention to our three large competitors.”*

As an alternative to a building a traditional peer group based on specific comparable data, some members said they prefer using a major stock index as a reference: *“We use an index to measure our performance and it seems to be working well. If you’re not performing better than the average of the S&P 500, you shouldn’t be getting paid more.”* However, this member noted the index is only used for performance measurement; the company uses *“a peer group to support our pay philosophy.”* Another member noted that using an index instead of a peer group for performance measurement helps smooth out unusual market activity: *“With a small group, one poor performing company can go through a turnaround, and then in terms of [total shareholder return] they are going to look like they way outperformed. If your company has more consistent good returns, you could be penalized.”*

Proxy advisor peer groups are not aligned with many companies’ peer groups

One proxy advisor, Institutional Shareholder Services (ISS), creates a peer group for each company that “generally contains a minimum of eight and maximum of 12 companies, comprised of companies within the same six-digit Global Industry Classification Standard (GICS) with revenue

ranging between 0.5- to 2.0-times the company's revenue."³ Members noted that this approach *"does not create groups [of companies] that you would consider peers."*

Meridian Compensation Partners shared an example of how drastically a peer group created using a GICS code can differ from a custom-built peer group. In this case, the median revenue of the peer group created using the code was \$1.2 billion, the median revenue of the company's peer group was \$64 billion, and the actual revenue of the company was \$78 billion.⁴ As one member said, *"The [group created using the GICS] code is not an accurate representation of peers."*

Members said their compensation committees' peer group choices are not affected by groups created by proxy advisors; however, many noted that they review the advisors' groups. One member has also engaged ISS in a discussion on peer groups as part of a broader compensation discussion: *"I went to ISS with the head of HR. We talked about the complicated process we go through to come up with our peer group. They said they appreciated the process and our deep understanding of the industry, and they did not indicate they had concern with our group."*

Peer group changes are inevitable

Changes to peer groups are inevitable as companies, markets, and industries evolve. One member said, *"You want the peer group to have stability, but in this environment there is not a lot of stability ... Companies that met the criteria to be included before may no longer meet it now and you have to take them out of the group."* This is especially true for companies in industries that have gone through major changes recently: *"If you take financial services, companies that might have been peers last year may not even exist anymore."*

One particular challenge that compensation committees face is how to deal with peers that go bankrupt: *"If a company in your peer group goes bankrupt, they disappear from the group – so now you're only comparing yourself to the survivors. I would like to be able to take into account their bad results because our performance may not have been great, but we sure did better than those peers. We are trying to figure out how to incorporate that."* Peer groups also typically undergo substantial changes when the company itself experiences "significant changes through merger and acquisition activity or a business strategy change."⁵

Outside of major industry shifts or significant company changes, members noted that they will make small changes to peer groups in order to maintain them. One member said, *"I try to resist changing the group every year. It is an imperfect science to begin with, and when you do make a change you can potentially open yourself up to a lot of criticism. There is not a lot of upside."* Another member said the committee *"looks at the peer group every year, but only makes small changes – one or two companies – every two years."* Best-practice guidelines also advise maintaining consistency, noting that "significant year-to-year changes in [the] comparator group will skew analysis of annual trends."⁶ Ultimately, one member said, *"You don't want to make*

³ "2011 US Compensation Policy: Frequently Asked Questions." Institutional Shareholder Services, last modified August 24, 2011.

⁴ See Attachment 1, Meridian Compensation Partners illustration, for complete comparison data.

⁵ Aubrey Bout and Brian Lane, "Smart Compensation," 28.

⁶ *Ibid.*

drastic changes to a group unless it's absolutely necessary, because it will look like you are trying to game the system."

If used incorrectly peer groups could contribute to real or perceived pay ratcheting

The *New York Times* last year reported, "Corporate boards appear to routinely use compensation peer groups to artificially inflate pay for their chief executives, helping to contribute to the cascading increases in executive compensation over the last several years, according to an academic study on corporate governance."⁷ Members themselves acknowledged they "*fear there can be a 'Lake Woebegone' effect at some companies, where everyone is considered above average.*" Importantly, Jun Yang, co-author of the aforementioned study, said that although there was evidence that peer group benchmarking increased pay, the increase was "not as much as critics have suggested."⁸

Members noted that in order to avoid real or perceived pay ratcheting through the use of peer groups, "*companies have to be consistent in their application.*" As one said, "*If your performance is at the 50th percentile, then you need to pay at the 50th percentile. If your performance is at the 75th percentile then that's where you pay. You can't come up with a justification for performing at the 50th and pay at the 75th.*" The member added, "*If you stray from this, then you lose your credibility.*"

Ensuring the company's pay percentile does not outpace the company's performance percentile may be the easy part; the hard part is accurately assessing the performance or pay of peers in order to determine the correct percentile. One member whose committee uses the peer group to evaluate the competitiveness of the company's pay package noted the difficulty: "*Even after you identify the peer group, it is tough to use when you don't know how they got to [the compensation] numbers ... We can't understand the factors that went into the number. The CEO got X, but what were the hurdles and challenges that that CEO had to overcome to get that pay? We don't know that, so it's hard to know how we compare.*"

In an attempt to address perceived pay ratcheting and demystify the peer group process, the SEC requires companies to disclose if they "engaged in any benchmarking of total compensation, or any material element of compensation, identifying the benchmark and, if applicable, its components (including component companies)."⁹ This information appears in the Compensation Discussion and Analysis (CD&A) section of the proxy. Some members, however, said the "*information disclosed is insignificant*" because it doesn't capture how the compensation committee weights particular companies or why certain companies were chosen over others to be included in the group. One member said, "*I think that should be explained in plain English in the CD&A. I'd like to see more specificity.*"

⁷ Cyrus Sanati, "[Study: Boards Use Peers to Inflate Executive Pay.](#)" *DealBook* (blog), *New York Times*, July 26, 2010.

⁸ Kelley School of Business, "[Firms Inflated CEO Pay by as Much as 10 Percent by Benchmarking Compensation with Top-paying Peers.](#)" news release, July 26, 2010.

⁹ Securities and Exchange Commission, [Executive Compensation and Related Person Disclosure](#) (Washington, DC: Securities and Exchange Commission, 2006), 333.

Committees must guard against management bias

The study cited above found that some companies inflate executive pay by selecting firms with highly paid executives for their peer group.¹⁰ Acknowledging this concern, one member said, *“At the end of the day, it is the compensation committee that signs off on any group or index that we use ... It’s our role to make sure that management is not playing games. With the amount of time that management spends on compensation, I think it is at best tilted in their favor somewhat. At worst, it is tilted in their favor a lot. They are certainly not going to look for groups that would penalize them.”* Another noted, *“You know the CEO already has a list. He’s looked at the proxies and he knows who he considers his personal peers and what they’re paid ... the committee is aware of that.”*

Ultimately, one member said, *“The process we go through with peer groups is more helpful, perhaps, than the end result. The discussions within the committee about what companies to include or not include are very useful and valuable.”* Another added, *“Peer groups are great if you accept them for what they are – sanity checks.”* In addition, members noted that peer groups also provide a good reference point when they are discussing compensation with a larger audience in the company: *“It’s helpful if you can point to a peer group and show where the company is within that group as an explanation for why compensation is what it is.”*

The effective compensation committee chair

With new and proposed regulation on the horizon, an already full compensation committee agenda continues to expand. One member commented, *“The audit committee used to be the workhorse of the board; now it is the compensation committee.”* Members shared a number of practices they use to ensure that committee meetings are run effectively and committee members remain educated and prepared for future challenges.

Pre-meeting practices

Members explained how they are spending increasingly more time in preparation for compensation committee meetings, focusing on ensuring that the right items are on the agenda and committee members are fully prepared to have a meaningful discussion at the meeting:

- **Setting the agenda.** For many chairs, setting the agenda for a meeting begins at the prior meeting and includes several preparatory conversations with the CEO, compensation consultant, and head of HR. One member shared an example: *“We always have next steps out of committee meetings. The consultant will take those away, and I will talk with the consultant about their analysis of those issues. Then I’ll have a call with the head of HR and the consultant. After that, I’ll have a second call with them to go through the agenda before it’s finalized [for the next meeting].”*

Members described several other elements they consider when setting the agenda:

¹⁰ Michael Faulkender and Jun Yang, [“Inside the Black Box: The Role and Composition of Compensation Peer Groups.”](#) *Journal of Financial Economics* 96, no. 2 (May 2010), 257–70.

- **Committee member input.** One member said, *“I’ll ask the committee members in the executive session if there are items that they want to put on the agenda, and then I’ll make sure they are incorporated into the agenda next time.”*
- **Time allotments.** One member said, *“I work on making sure we are spending our time on the most challenging issues rather than spending time on things that are necessary but can be covered in a short period of time.”*
- **Attendance.** Members said it is critical that the right people are in the room for committee meetings. Several members said their compensation consultant attends every meeting, while others said they *“will sometimes have the [compensation] consultant and will sometimes have [human resources], depending on the agenda.”*
- **Preparing meeting participants.** To promote effective use of time in the committee meeting, members may spend time with all participants to ensure they are adequately prepared for the meeting. Members said they make the following preparations:

- **Provide feedback to management presenters.** One member said, *“I will give management feedback so that they can make adjustments to the materials before the meeting.”* However, several members advised, *“[You don’t want to] become a committee of one. The chair has a role in shaping what goes to the committee, but they also have to let management teams share their perspectives with the committee.”*

One member said, *“I know where the committee stands on a lot of issues, so if management is planning to present something that I don’t think the committee is going like, I might say, ‘I don’t think that’s going to fly, but if you feel strongly about it, you should present it.’”* Similarly, another member said, *“If I don’t agree with something they are presenting, I will tell them beforehand, ‘I’m not going to support that when you present it at the meeting,’ but they are still free to bring it.”*

- **Notify committee members of potentially contentious agenda items.** Several members said they have conversations with members prior to the committee meeting, *“especially if there is an item they have to think about.”* One member calls each committee member prior to each committee meeting, while others only have pre-meeting calls if they *“expect the committee to have an issue with an item.”*
- **Deliver committee materials well in advance of the meeting.** Members said it is *“increasingly important to get materials out to committee members early. Packets are getting longer and longer. We might have 200 pages, and we don’t go through the materials at the meeting – we have discussions. If you’re on this committee, you need to do your homework beforehand, and to do that, [you] need materials early.”* In addition to the typical meeting materials, one member also includes a *“plain English translation of the complex items that need to be approved.”*

Practices during the meeting

Members said the role of the chair in the compensation committee meeting is to ensure the discussion is targeted, meaningful, and effective. Members described several ways to accomplish this:

- **Optimizing executive sessions.** Several members suggested that executive sessions should be held at every meeting *“to establish a precedent”* that makes them seem *“more routine and less awkward.”* One member prefers holding the session prior to the committee meeting in order to *“highlight important agenda items and determine if [a member] wants to spend more time on an item.”* This member noted, *“It is helpful for the committee to hear what happened since the last meeting.”* Meanwhile, another member opts for an executive session at the end of the committee meeting: *“We hold an executive session after the committee meeting to make sure everyone is comfortable with what we saw. If they want more information, we ask management to present that at the next meeting.”* Another member said the compensation committee has an executive session to *“begin and end the meeting.”* Yet another prefers more fluid executive-session scheduling, noting, *“When we hold executive sessions really depends on the issue. We may need one before or we may need one after, depending on what is on the agenda.”*
- **Requiring that committees see everything twice.** Several members said they typically don’t ask the committee to approve items the first time they see them. One member said, *“We will usually get a presentation and have a discussion in one meeting and then act on it at the next meeting.”* Another said, *“We have a ‘two bites of the apple’ approach so that members have time to process and digest the issues before they are asked to make a decision.”*
- **Managing the presenters.** One member explained, *“Everyone on the committee has done their homework, so the chair needs to rein in presenters if they start going over the materials everyone has already read.”* Another member added, *“It can easily turn into a dog-and-pony show if you don’t manage it.”*

Ongoing practices

Outside of the meeting cycle, members keep the committee functioning efficiently through a number of ongoing practices:

- **Provide committee member education.** One member described a *“boot camp”* style education session: *“The compensation consultant created a boot camp for us. It was in addition to our typical committee meetings, and we spent about four hours on it. We covered every topic. We know what the philosophy is, but do we really believe that? What have we done in the past? What is best practice? What does ISS say? We thought about if we could reset the whole pay plan, what would we do differently?”* The member noted, *“After going through this, we had a committee that was on the same page and understood all the issues.”*
- **Understand the technical details of compensation structures that affect payouts.** One member shared a story about a compensation committee that *“was not aware of how the*

value we granted was transferred into equity, and then how that stock was valued.” This resulted in CEO compensation that was \$5 million higher than what the committee expected. This member said there were a number of key details that the committee should have understood, including the following:

- **Stock valuation assumptions.** *“We didn’t see the assumptions that went into the stock calculations.”*
- **Compensation consultants involved.** *“We didn’t know that there was another compensation consultant performing the stock calculations. This consultant was using a different valuation model than the committee’s independent consultant.”*
- **Grant window.** *“There was a 90-day window on stock grants. By the time they were granted, the stock price was different.”*

As a result of these initial oversights, the member said, *“We took a hard look at the sausage factory – what the assumptions were, who was making them, and what the potential effects of those assumptions could be. [We ultimately decided to] shorten the grant window, have the audit committee review the option valuations, and we’re getting more specific in the proxy about how options are valued and who the consultants are.”* To avoid similar situations, one member said, *“We always ask management to show us exactly what is going to appear in the proxy. We want to see the proxy tables before we make our final decision.”* Another member added, *“The board’s compensation consultant should always perform the stock valuation or at least review the valuation.”*

- **Regularly review the pay philosophy and consider views of critics.** One member said the committee regularly *“reviews the compensation philosophy – what it is and why it’s that way.”* The member also asked the compensation consultant to provide *“a dissident perspective: if someone had an axe to grind with us, what parts of the plan would they go after?”* The member said the *“dissident report was eye-opening.”* As a result, *“[The committee considered] the places we could agree with the dissident. We made sure we knew the reason we were doing each of the things [a dissident might go after]. We looked at how and why our philosophy was different than others. We also looked at what number would be in the headlines if someone left.”* The member said the intention of this review was to *“get to a place where we understood our philosophy, the dissident’s approach, and why we can defend our philosophy.”*
- **Safeguard the committee’s role.** One member said, *“It’s important as a chair to make sure that management isn’t trying to push decisions along in between meetings with just the chair. Sometimes [management] will want me to make a decision, and I will say, ‘No, I want the rest of the committee to weigh in.’ It’s really important that the committee doesn’t think decisions have already been made before we get into the board room.”*
- **Communicate compensation philosophies to the broader board audience.** One member has had a *“dashboard document”* created that *“summarizes the company’s compensation philosophy and gives the pay for the top five [executives].”* The member

explained, “*This foldout page is something that goes to the full board. If anyone asks about the compensation plan, [directors] have this one page to refer to.*”

- **Seek feedback.** One member said, “*The board goes through an evaluation process. We get feedback on how the committee meetings are run, how the chair is doing, and if there are issues getting items on the agenda.*”

Discussions with William B. Chandler III and H. Rodgin Cohen

Members enjoyed a discussion with Chancellor William B. Chandler III, partner at Wilson Sonsini Goodrich & Rosati and former chancellor of the Delaware Chancery Court, over dinner on October 3, and with H. Rodgin (Rodge) Cohen, partner and senior chairman of Sullivan Cromwell, LLP, on October 4.

William B. Chandler III

Chancellor Chandler explained that a majority of business law cases are decided in Delaware’s Court of Chancery, which is “uniquely structured for consistency.”¹¹ A recent article offers Chancellor Chandler’s description of the court: “A court of equity drawing on an ancient English tradition, it has no juries and awards no punitive damages, factors that produce ‘weird outlier cases’ in ordinary courts of law, he explains. Judges hear suits individually but consult behind the scenes to maintain a unified doctrinal front. ‘We often talk about difficult issues we are wrestling with,’ the chancellor says. ‘This is enormously beneficial as it ensures the coherent development of our law.’”¹²

As Chancellor Chandler discussed the future of the court, three key themes emerged for directors:

- **The business judgment rule is “alive and well.”** Many members questioned whether the business judgment rule would be able to withstand the increasing number of shareholder suits, especially given recent court rulings that favored the shareholders. Chancellor Chandler explained that the long-standing business judgment rule is still – and will continue to be – the foundation upon which courts will make decisions. He noted that unless there is a deliberate indifference in their duties, directors can rely on the business judgment rule.
- **The changing face of shareholders complicates the director’s role.** Chancellor Chandler and members discussed the challenge that directors face in representing shareholders, who are increasingly short-term oriented, and also in making decisions for the long-term health of the company. When these two interests are misaligned, Chancellor Chandler suggested that directors should be making decisions that are in the long-term interest of shareholders, acknowledging that this may be at odds with the views of short-term investors.
- **Say-on-pay lawsuits will likely have little effect on directors.** Chancellor Chandler explained that a number of current say-on-pay derivative lawsuits are citing directors for breach

¹¹ Craig Mellow, “[The Life and Times of Judge William Chandler](#),” *Boardmember.com*, first quarter 2011.

¹² [Ibid.](#)

of fiduciary candor, on account of the compensation committee approving the CD&A disclosure that indicates pay and company performance were linked, when in fact the plaintiffs claim they were not. He said that compensation committees needed to be careful in the way they phrase the pay-for-performance link in the CD&A: “If you say pay and performance are tied, they are going to hold you to that.” Chancellor Chandler said he does not anticipate these derivative lawsuits will be successful, but they will inevitably cost the company money in legal fees and potential settlements. With regard to settlements, Chancellor Chandler told members “you stop them by fighting them.”

H. Rodgin Cohen

In Mr. Cohen’s discussion with members on director liability, the following observations emerged:

- **Successful derivative say-on-pay lawsuits are unlikely, but directors may be unseated.** A number of companies are facing derivative lawsuits as a result of failed say-on-pay votes, but Mr. Cohen noted that these lawsuits are generally not likely to be successful. He said the greater risk is that directors, particularly those who are compensation committee members, may be in jeopardy of losing their board seats. He explained that proxy advisors and activist shareholders are formulating what they consider an acceptable level of support for say-on-pay votes. If “acceptable” support is not attained and the company does not make a meaningful change in their pay practices, proxy advisors and activists may oppose the reelection of compensation committee members at the annual meeting.

Members were concerned with the disproportionate power of the minority shareholders in this case and the lack of clear guidance on an “acceptable level” of support and “meaningful” change in pay practices. Nonetheless, members agreed, *“Getting reelected should not be the concern.”* One member said, *“You have to make the right decisions and if you don’t get reelected, you don’t get reelected. You want people to stand on that principle. You can’t make decisions in order to stay on a board.”*

- **Regularly communicating with investors may mitigate some say-on-pay risks.** Mr. Cohen suggested companies should be talking with leading shareholders on a regular basis rather than episodically when they run into opposition. Using say-on-pay as an example, Mr. Cohen suggested that negative votes were a reaction to the performance of companies rather than their particular pay plans. He noted that if the company had a history with shareholders and shareholders understood the pay, they might not run into as much opposition at the time of the vote.
- **In lieu of regulatory-mandated proxy access, activists are pursuing proxy access through stockholder proposals.** Mr. Cohen suggested that companies could see a wave of shareholder proposals from activists seeking proxy access, as well as written consent proposals, in 2012. With regard to written consent proposals, Mr. Cohen noted that corporations should be focused on avoiding the lack of transparency and information in a “traditional” written consent. Written consent structures should require the solicitation of all shareholders, not just a

percentage; there needs to be a reasonable period of time between commencement and delivery of consent; and the materials should be delivered as a proxy.

About this document

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**Analysis of Multiple Peer Group Dimensions Using ISS Requirements
Illustration Using Procter & Gamble as Test Company**

Company Name	Russell 3000 GICS 3030		ISS Top 5		P&G Custom Peer Group	
	Y2010 Revenues (\$Mn)	Y2010 Market Cap (\$Mn)	Y2010 Revenues (\$Mn)	Y2010 Market Cap (\$Mn)	Y2010 Revenues (\$Mn)	Y2010 Market Cap (\$Mn)
Colgate-Palmolive Co	\$15,564	\$38,793	\$15,564	\$38,793	\$15,564	\$38,793
Kimberly-Clark Corp	\$19,746	\$25,707	\$19,746	\$25,707	\$19,746	\$25,707
Avon Products	\$10,863	\$12,472				
Clorox Co	\$5,534	\$8,755	\$5,534	\$8,755		
Lauder (Estee) Cos Inc -CI A	\$7,812	\$6,764				
Church & Dwight Inc	\$2,589	\$4,910	\$2,589	\$4,910		
Energizer Holdings Inc	\$4,248	\$4,719	\$4,248	\$4,719		
Herbalife Ltd	\$2,734	\$4,050				
Nu Skin Enterprises	\$1,537	\$1,880				
Spectrum Brands Holdings Inc	\$2,567	\$1,387				
USANA Health Sciences Inc	\$518	\$694				
Synutra International Inc	\$249	\$659				
Central Garden & Pet Co	\$1,524	\$641				
WD-40 Co	\$322	\$586				
Prestige Brands Holdings	\$337	\$578				
Inter Parfums Inc	\$460	\$574				
Revlon Inc	\$1,321	\$480				
Medifast Inc	\$258	\$445				
Elizabeth Arden Inc	\$1,104	\$418				
Schiff Nutrition Intl Inc	\$214	\$204				
Nutraceutical Intl Corp	\$180	\$163				
Female Health Co	\$22	\$142				
Natures Sunshine Prods Inc	\$350	\$139				
Oil Dri Corp America	\$219	\$114				
Exxon Mobil Corp					\$341,578	\$368,712
Wal-Mart Stores Inc					\$420,016	\$199,721
General Electric Co					\$149,060	\$194,875
Chevron Corp					\$189,607	\$183,634
Intl Business Machines Corp					\$99,871	\$182,329
At&T Inc					\$124,280	\$173,636
Johnson & Johnson					\$61,587	\$169,856
Coca-Cola Co					\$35,119	\$152,720
Pfizer Inc					\$67,791	\$140,254
Merck & Co					\$45,987	\$111,035
Pepsico Inc					\$57,838	\$103,538
Verizon Communications Inc					\$106,833	\$101,142
Conocophillips					\$175,752	\$100,054
Hewlett-Packard Co					\$126,033	\$95,336
United Technologies Corp					\$54,326	\$72,691
3M Co					\$26,662	\$61,692
Home Depot Inc					\$67,997	\$60,259
Kraft Foods Inc					\$49,207	\$55,041
Altria Group Inc					\$16,892	\$51,402
Boeing Co					\$64,306	\$47,873
Du Pont (E I) De Nemours					\$32,134	\$45,535
Target Corp					\$67,390	\$38,824
Lockheed Martin Corp					\$45,803	\$25,177
25th %ile	\$306	\$439			\$45,803	\$51,402
Median	\$1,213	\$650	\$5,534	\$8,755	\$64,306	\$100,054
75th %ile	\$3,113	\$4,766			\$124,280	\$169,856
P&G	\$78,938	\$172,737	\$78,938	\$172,737	\$78,938	\$172,737