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September 15, 2009

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-9303

Re: File No. S7-13-09; Proxy Disclosure and Solicitation Enhancements, Proposed Item 407(e) (3) (iii) of Regulation S-K

Dear Ms. Murphy:

I applaud the efforts of the Commission's recommendations in advancing better disclosure rules with regard to risk, presentation of equity awards and use of executive compensation consultants. I would welcome the opportunity to address specific questions or requests for further information.

This letter is a comment on the Securities and Exchange Commission's ("SEC" or the "Commission") proposed rules on executive compensation and related party disclosure, Item 407(e)(3)(iii) of Regulation S-K ("Proposed Regulations") and represents the views of James F. Reda & Associates, LLC, advisors to Compensation Committees of Fortune-100 companies on matters of executive and board pay. The purpose of this letter is to address the Commission's queries regarding proposed changes to Item 407(e) of Regulations S-K.

Over the past ten years, I have addressed the issue of independent committee operations several times. I have argued that the providers of traditional compensation advice have significant economic incentives to provide other unrelated human resources services in addition to executive compensation advice. This creates a direct conflict of interest and gives the appearance of a lack of independence with regard to their advice. My book, co-authored with Stewart Reifler and Laura Thatcher, entitled the "Compensation Committee Handbook (John Wiley)" is in its third edition and has been in continuous publication since 1999.

On April 6, 2006, I addressed the SEC in a letter which provided comments with regard to Executive Compensation and Related Person Disclosure S.7-03-06 (see Attachment B).

On December 5, 2007, I testified before the United States House of Representatives Committee on Oversight and Government Reform with regard to the "Role of Executive Compensation Advisors"

In March 2008, I wrote an article entitled "How 'Independent' is Your Compensation Advisor" (The Corporate Board: March/April 2008) (see Attachment C).

This summer I participated as a technical advisor to the Conference Boards' report entitled "The Conference Board Task Force on Executive Compensation." This report will be released this month.

Finally, we just completed a study on "Executive Compensation Trends for 2009: Balancing Risk, Performance and Pay." (See Attachment D). The findings of this study show that:

- A shift away from long-term incentives to include more focus on short-term incentive plans;
- Short-term incentive plan performance measures shifted to profit and cash flow from capital efficiency and non-financial performance goals;
- Long-term incentive plan performance measures shifted to capital efficiency, cash flow and total shareholder return; and
- Companies are increasing their emphasis on time-vested restricted stock and restricted stock units.

Best regards,

James F. Reda
Founder and Managing Director

Attachments

A. Our Comments Regarding File No. S7-13-09; Proxy Disclosure and Solicitation Enhancements, Proposed Item 407(e)(3)(iii) of Regulation S-K
B. Our letter dated April 6, 2006: File No. S7-03-06; Proposed Rules on Executive Compensation and Related Party Disclosure, Items 402 (b) and 407 (e) of Regulation S-K
C. "How 'Independent' is Your Compensation Advisor" (The Corporate Board: March/April 2008) (under separate cover)
D. Study entitled "Executive Compensation Trends for 2009: Balancing Risk, Performance and Pay" (under separate cover)

Attachment A.
Our Comments Regarding File No. S7-13-09; Proxy Disclosure and Solicitation Enhancements, Proposed Item 407(e)(3)(iii) of Regulation S-K

Introduction

My name is James Francis Reda, Founder & Managing Director of James F. Reda & Associates, LLC based in New York City. I am an independent compensation advisor to numerous publicly traded companies. In my 22 years of executive compensation consulting experience I authored two books, co-authored another book and published over twenty articles in the area of executive compensation.

Over the past several years the Commission has taken significant steps to improve executive compensation disclosure. Specifically, the changes to Items 407(e) address the key points I raised in my testimony to Congress and in my letter to the Commission dated April 6, 2006. I believe that requiring companies to disclose in greater detail the relationship with their executive compensation advisors will provide shareholders with the information necessary to assess whether or not compensation decisions are being made within a truly independent process. I also believe that these changes further the goal of compensating executives commensurate with performance.

As stated in my letter to the Commission, I believe that the decision making process is crucial, and that it must be truly independent if it is to serve the best interests of shareholders. This is the only way that publicly traded corporations can achieve a fair and equitable executive compensation program that pays for performance and aligns the interests of executives with those of shareholders. Lastly, by requiring companies to disclose compensation consulting, executive compensation consultants, specifically those who render additional compensation services will be more motivated to render advice that will withstand scrutiny of stakeholders, and thus, reduce executive compensation risk.

Section of Risk: Our Comments on Balancing Risk, Performance and Pay

The proposed disclosure rules seek to provide a better balance of risk, performance and pay.

Companies strive to balance risk vs. reward vs. corporate performance. Recent proposed legislation and SEC rules changes will require companies to discuss corporate risk with regard to executive compensation. Each company needs to determine the executive compensation program that is right for them taking into account the various types of risk.

There are various types of risk that need to be addressed. Here are a few of the risks:

- Setting the wrong goals which may substantially impair the company and not create value;
- Paying too much compensation that is not closely connected to performance (e.g., restricted stock, guaranteed or retention bonuses, large severance payouts with or without a change-in-control, large pension entitlements, generous perquisites);
- Paying too much of the pay in incentive compensation combined with a small salary that may encourage risky behavior with either corporate strategy or financial accounting;
- Creating windfall compensation (e.g., large severance payout or extremely large bonus);
- Overpaying executives in a systematic way over a period of time which depletes the financial vitality of the company; and
- Paying cash bonuses for short-term performance that turns out to be specious and ultimately causes stock price to drop over time.

There are many examples that are associated with each of these types of risks.

Suggestions for ways to reduce risk and align pay with performance:

- Increased emphasis on long-term pay: Unlike short-term incentives, long-term pay keeps management focused on long-term value creation and protects shareholders from paying compensation based on short-term results, and at times, specious results. Subject more compensation to stock price risk: Partial (40% or more) deferral of bonus into company stock: This protects companies from paying enormous payouts for short-term spikes. Other ideas to consider to subject pay to stock price risk:
    - Stock ownership requirements: Requiring significant ownership in the company is a way in which management provides additional "skin in the game" and subjects wealth accumulation to stock price risk.
    - Hold equity until retirement: While similar to stock ownership guidelines, this prevents management from "unloading" equity during high periods of growth and reducing their link to shareholders.
- Pay Clawbacks: Protects against the generation of "bad business" that first appears to be profitable but is reversed when the economy or other factors change and ultimately is unprofitable.

- Impose caps on bonus payouts and reduce maximum payouts: When companies have unexpected and transitory growth, bonus payment should be capped. What we have learned during this financial meltdown is that companies which had enormous growth were unable to sustain that level of growth and were substantially affected by downturn.
- Careful use of perquisites: Although perquisites represent a relatively small portion of pay, they never-the-less have become a focal point of shareholders, shareholder activist groups, and media ire. No gross-ups on pay or benefits of any type.

Section of Executive Compensation Consultants: Answers to Specific Comments Provided by Commission on Compensation Consultants

SEC Question: Will this disclosure help investors better assess the role of compensation consultants and potential conflicts of interest, and thereby better assess the compensation decisions made by boards?

Our Answer: Yes. Throughout the history of law and business, compensation (sometimes in the form of goods, services and other favors) has always been a bellwether test of independence. Theoretically it may be possible for the same firm to receive compensation from both sides (board and management) where divergent interests may exist. However, based on experience, laws and customs have evolved to at least require disclosure of the financial relationship that exists between the two parties (sometimes referred to as a conflict of interest).

Our position is that a fair, independent and transparent process will balance risk, pay and performance. Simply put, the process should be made as independent as possible by disclosing to the shareholders how much was paid or will be paid to the company's senior executives and letting our free markets come to their own conclusions. These Proposed Regulations do both: they should make the process more independent as more and more companies will use truly independent compensation consultants, and they will force companies to provide additional information on fees paid in the process of setting executive pay.

Government intervention in the form of limits (including those limits imposed by our tax system) causes a dislocation to our fair market system of setting pay and thus may result in a suboptimal result. For example, just look at all of the effort that companies and their outside advisors put into avoiding being subjected to non-deductible amounts associated with IRS Code Section 162(m).

By requiring the disclosure of aggregate fees, the nature of additional services provided by the consultant, and the portion of those fees that are related to executive compensation, investors will be able to better assess the independence of the compensation consultant. Furthermore, I believe that the disclosure of a compensation committee's involvement in approving non-executive compensation consulting services establishes that the ownership of the relationship lies with the compensation committee, not with management. Lastly, by requiring management to attest to whether the hiring of the executive compensation consultant by the committee was recommended, subject to approval, or screened by management is an excellent way of demonstrating to investors whether or not the compensation consultant is truly independent.

A report prepared for the United States House of Representatives Committee on Oversight and Government Reform entitled *Executive Pay: Conflicts of Interest Among Compensation Consultants*, along with the 2003 Blue Ribbon Panel of the National Association of Corporate Directors, supports my assertion that compensation committees better serve their shareholders by using different consulting firms with respect to executive and non-executive related services.

Some academic articles have been presented as a vindication of the "conflicted consultant model", but it is difficult to provide conclusive proof if the academics do not have access to the data that shows the fees paid for executive consulting services and fees paid for other services. This is what this proposed rule calls for.

Would the disclosure of additional consulting services and any related fees adversely affect the ability of a company to receive executive compensation consulting or non-executive compensation related services? If so, how might we achieve our goal while minimizing that impact?

No. Disclosure does not mandate who a company must retain to provide consulting advice. This disclosure is similar to the rule provided in the Sarbanes-Oxley Act of 2002 which requires audit firms who also render tax consulting advice to the same company to obtain audit committee pre-approval prior to rendering such tax services. While this arrangement has encouraged many companies to utilize different firms for audit and tax services, the rule has not prevented access to these firms, nor has it been prohibitive where it makes business sense to retain the same audit firm to render tax advice. Within the large human resource consulting firms, there is no shortage of quality consultants who can provide executive and non-executive compensation based services. Although this rule may elicit ire among the larger full service consulting firms, it should not adversely affect the ability of companies to receive quality executive compensation and non-executive compensation consulting services from independent firms that provide these types of services..

Are there competitive or proprietary concerns that the proposed disclosure requirements should account for? If so, how should the amendments account for them if the compensation consultant provides additional services?

No. Companies are already required to disclose the name of their executive compensation consultant. I do not see how the disclosure of amounts paid to an outside advisor would cause any proprietary or competitive harm to companies or consulting firms. In fact, it may provide shareholders with additional information about the costs associated with providing various human resource programs, which may, in turn, lead to more focus on managing these costs.

Are there additional disclosures regarding the potential conflicts of interest of compensation consultants that should be required? For example, would requiring disclosure of any ownership interest that an individual consultant may have in the compensation consultant or any affiliates of the compensation consultant that are providing the additional services to the company help provide information about potential conflicts? If so, why?

Yes. The disclosure of ownership interest of the individual executive compensation consultants will clearly show that the executive compensation consultant is inextricably tied to the economic interests of their own consulting firm. In my letter to the SEC and in my testimony on Capital Hill, I argued that traditional providers of compensation advice have significant economic incentives to provide other unrelated human resource services in addition to compensation advice. It is my belief that this type of relationship causes a direct conflict of interest and gives the appearance of a lack of independence with regard to executive compensation advice rendered. This assertion is supported with research by the U.S. House Committee on Oversight and Government, specifically:

> *According to experts on executive compensation, compensation consultants can have a conflict of interest if they provide other services to a company at the same time that they are providing executive compensation advice. The concern is that the ability of consultants to provide independent, unbiased advice to directors regarding the pay of senior executives can be compromised if the senior executives are at the same time paying the compensation consultants to provide other services to the company. These other services can include a wide range of activities, including employee benefit administration, human resource management and actuarial services.*

The proposed disclosure requirement calls for disclosure of services during the prior year. Should we also require disclosure of any currently contemplated services in order to capture a situation where the compensation consultant provides services related to executive pay in one year and in the next year receives fees for other services? If so, should we require that fees for the currently contemplated services be estimated? Is there a better way to require that information, for instance through the date of the filing? Should we require disclosure for the prior three years?

No. I believe this requirement to be overly cumbersome because both executive and non-executive engagements are not necessarily recurring and thus do not conform to fixed time schedules. I also do not believe that the incremental value of this type of disclosure improves independence. By requiring the aggregate disclosure of fees each year, shareholders can assess over time whether the advice rendered to compensation committees may have been compromised. The goal of the disclosure rules is to hold the compensation committees accountable for the independent relationship with the executive compensation consultant, not to force the company and committee to spend additional time accounting for past and future consulting engagements.

Is the proposed exclusion for consulting services that are limited to broad-based, nondiscriminatory plans appropriate? Should we consider any other exclusions for services that do not give rise to potential conflicts of interest? If so, describe them.

Yes/No. The proposed exclusion for broad-based non-discriminatory plans is a reasonable exclusion. However, it is my belief that the Commission should not contemplate what types of consulting services should be “excluded” from disclosure. As provided above, the purpose of this rule is not to decide what a permissible non-executive compensation consulting service is; rather, the purpose of this rule is to provide shareholders with information to assess whether, in the aggregate, there is an inherent conflict of interest based on the amount of non-executive compensation related services the consulting firm provides to the company.

Should we establish a disclosure threshold based on the amount of the fees for the non-executive compensation related services, such as above a certain dollar amount or a percentage of income or revenues? If so, how should the threshold be computed?

No. Establishing such an arrangement would allow the committee to re-characterize fees, potentially eliminating the need for disclosure.

Would disclosure of the individual fees paid for non-executive compensation related services provided by the compensation consultants be more useful to investors than disclosure of the aggregate fees paid for non-compensation related service provided as proposed?

No. This will further complicate disclosure. The objective of investors is to understand the type of services being rendered and the relationship between total fees paid for non-executive compensation versus total fees for executive compensation related services. The requirement to provide additional details, such as the amount of "individual fees" for each non-[executive] compensation service, creates an unnecessary burden to the company and provides no incremental benefit with regard to independence concerns.

Would disclosure about the fees paid to compensation consultants and their affiliates help highlight potential conflicts of interest on the part of these compensation consultants and their affiliates? Is fee disclosure necessary to achieve this goal, or would it be sufficient to require disclosure of the nature and extent of additional services provided by the compensation consultant and its affiliates? Should disclosure only be required for fees paid in connection with executive compensation related services?

Yes/Yes/No. Disclosing total fees paid to compensation consultants and their affiliates is important. There is no disputing that traditional providers of compensation advice have significant economic incentives to provide other unrelated human resources services in addition to executive compensation advice. By requiring companies to disclose the level of fees and the nature of non-executive compensation related services, along with providing a statement that the compensation committee has approved the non-executive compensation services, investors can better evaluate the independence of the executive compensation advisor.

Although I do not believe that the fee for each individual non-executive compensation service should be disclosed, I do agree that a description of the non-executive compensation related services should be mentioned. I believe that this disclosure could be useful to both investors and the committee by providing a platform in which to justify the use of the executive compensation consultant (or affiliate) if the committee were to engage the same consultants.

Disclosure of fees for <u>both</u> executive compensation and non-executive compensation services should be required because the ratio between these two types of services illuminates the potential conflict. For example, if a company were to have a situation in which the firm engages a consulting firm where the fees for executive compensation consulting fees were significantly higher than non-executive compensation services, the investor would likely conclude that the company's executive compensation advisor would most likely be less conflicted than if the opposite were the case.

Should we make any special accommodations in the proposed amendments to Item 407(h) for smaller reporting companies? If so, what accommodations should be made and why?

No. I do not believe the size of a public company should be a determining factor with regard to these disclosures and, thus, I do not favor an accommodation for "smaller" companies. The size of a company should not in any way diminish the importance of disclosing the independence with respect to the company's executive compensation advisor or consultant. Furthermore, because "smaller" companies don't necessarily stay "small", a compensation decision/recommendation made when the company is "small" may adversely affect the company and/or its programs when it ceases to be "small".

Are there other categories of consultants or advisors whose activities on behalf of companies should be disclosed to shareholders? If so, what kind of disclosure would be appropriate?

No. I believe the distinction between compensation and non-compensation based services sufficiently lays out the information investors require with respect to determining whether executive compensation advice received by the compensation committee was independent. I believe that categorizing consultants or advisors would only confuse the relevant issues.

Attachment B: Our letter dated April 6, 2006: File No. S7-03-06; Proposed Rules on Executive Compensation and Related Party Disclosure, Items 402 (b) and 407 (e) of Regulation S-K.

JAMES F. REDA
& ASSOCIATES, LLC

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April 6, 2006

Ms. Nancy Morris
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-9303

Re: File No. S7-03-06; Proposed Rules on Executive Compensation and Related Party Disclosure, Items 402 (b) and 407 (e) of Regulation S-K

Dear Ms. Morris,

This letter is a comment on the Securities and Exchange Commission's ("SEC" or "Commission") proposed rules on executive compensation and related party disclosure, Item 402 (b) and Item 407 (e) of Regulation S-K ("Proposed Regulations") and represents the views of James F. Reda & Associates, LLC, advisors to Compensation Committees ("Committees") on matters of executive and board pay. We serve in the role of outside advisor to the Committees of Fortune-100 companies. The purpose of this letter is to focus more attention on an independent decision making process for Committees, particularly in relation to outside compensation advisors.

The traditional providers of compensation advice have significant economic incentives to provide other unrelated HR services in addition to compensation advice. This causes a direct conflict of interest and gives at least the appearance of lack of independence with regard to their advice.

In the following pages, we outline specific suggestions for addressing the issue of independent Committee operations, and cite supporting arguments made by Professor Jeffrey Gordon of Columbia Law School, The Conference Board, the National Association of Corporate Directors ("NACD"), and other leading corporate governance experts.

I applaud the efforts of the Commission in preparing the proposed rules and welcome the chance to address questions or requests for further information.

Best regards,

James F. Reda
Managing Director

Our Comments on File No. S7-03-06; Proposed Rules on Executive Compensation and Related Party Disclosure, Item 402 (b) and 407 (e) of Regulation S-K

Introduction

My name is James Francis Reda, Managing Director of James F. Reda & Associates, LLC based in New York City. I am an independent compensation advisor to numerous publicly traded companies. I have about 18 years of executive compensation consulting experience and have authored two books and co-authored another as well as over twenty articles in the area of executive compensation.

Numerous comment letters have and will be submitted to the SEC that address technical matters relating to the completeness and accuracy in disclosing executive compensation programs and associated dollar amounts. These discussions are crucial, but we will not address them here.

Our primary issue is, from a shareholder's point of view, "Are executive compensation decisions being made within a truly independent process?"

Business as usual cannot continue in the world of executive compensation. Lucian Bebchuk and Yaniv Grinstein have shown that the ratio of aggregate pay for top-five executives to aggregate earnings has increased from 5% in the period 1993-95 to 10% in 2001-03. [1] Compensation Committees need to take a hard look at these numbers and reassess their operations from stem to stern. The SEC can help Committees by providing them with a higher standard of disclosure to verify the independence of compensation advice.

We view the decision making process as crucial and in the best interest of shareholders that it be truly independent. This is the only way that publicly traded corporations can achieve a fair and equitable executive compensation program that pays for performance.

[1] BEBCHUK and GRINSTEIN supra note 7, at 1.

Summary of Recommended Changes to Proposed Regulations

Overall, we recommend the SEC consider changes to the Proposed Regulations, which are as follows:

> (1) Require that the members of the Committee sign the Compensation Discussion & Analysis ("CD&A") report as proposed by Professor Jeffrey Gordon in his forthcoming article for the Journal of Corporation Law, *Executive Compensation: If there's a Problem, What's the Remedy? The Case for "Compensation Discussion and Analysis"*.[2]
>
> (2) Where the Proposed Regulations refer to compensation consultants, change "consultants" to "advisors," to include other outside advisors, such as legal advisors, that may be retained to advise the Committee ("Compensation Advisors").
>
> (3) Require further disclosure pertaining to Compensation Advisor independence, such as the procedure the Committee followed in choosing a Compensation Advisor, a table presenting fees paid to Compensation Advisors, the type of work performed by the Compensation Advisor, and the relative fee structure for work performed for the Committee and for management, if applicable. The Committee should provide a description of the work performed when the Compensation Advisor worked with management. This disclosure is similar to that found in the Audit Committee Report and has been crucial in making the audit process independent of management.

1. Approval of CD&A by Committee

The CD&A was proposed to give shareholders additional information about the basis for the executive compensation decision making process and to provide more specific justification of the structure and amounts paid to senior executives. The current executive compensation disclosure rules include a "Compensation Committee Report" that requires that the Committee describe the compensation paid to all Named Executive Officers, with an additional discussion of CEO pay. This requirement has been in place since 1993 (the last time the Commission changed the disclosure rules) and has given the Committee an opportunity to discuss their decisions and decision making process. But, overall, the effect of this reporting requirement has been minimal.

We view the CD&A as a step in the right direction for shareholders. We also endorse the thinking behind requiring filing vs. a disclosure in that a filing carries additional liability. However, the SEC must further stress that the CD&A is the responsibility of the Committee. It is surprising that the Proposed Regulations cite Professor Gordon's article

[2] Jeffrey N. Gordon, *Executive Compensation: If There's a Problem, What's the Remedy? The Case for "Compensation Discussion and Analysis,"* Columbia Law School, The Center for Law and Economic Studies Working Paper No. 273/2006 forthcoming, Journal of Corporation Law (Summer 2006), available at http://ssrn.com/abstract=686464.

as the basis for suggesting the CD&A, but they do not require approval of the CD&A by the Committee[3].

As part of board ownership for compensation decisions, the members of the Committee should be required to sign their names to the end of the CD&A report, completely attesting to their pay decisions as business judgments and staking their reputations on the dotted line. The CEO and CFO can attest to the accuracy of the compensation data, particularly the change-in-control severance amounts, but the Committee should have final approval authority over the CD&A.
With Committee member signatures, the CD&A will strengthen the basic premise that the Committee is accountable for pay decisions and, in particular, the decision making process

2. Broaden Meaning of Compensation Consultants to Compensation Advisors

Committees are seeking guidance from an increasing number of advisors, not all of which focus exclusively on providing independent advice to Committees.

Law firms, actuarial firms, and other business advisors are being consulted by directors when determining executive pay. Lawyers are bound by ethical standards and a duty to serve clients. They can be subject to censure. On the other hand, consultants do not even have minimum qualification standards. Lawyers are advocates for their clients. If they are hired by the committee they must go through conflict checks and get releases from conflicted parties.

Therefore, we advocate that the terminology be broadened from "compensation consultants" to "compensation advisors." A description of the advisor's business should be included in the CD&A report. In the next section, we review additional items which should be disclosed in order to determine the independence of the compensation advisor.

With regard to law firms, we would suggest that the law firm be named, but that the suggested fee disclosure (see our next recommendation) apply to those firms whose advice pertained to setting pay and pay techniques, which are typically limited to executive compensation consultants.

3. Further Disclosure on Compensation Advisor Independence

A key ingredient for an independent decision making process is a truly independent compensation advisor. In a recent report, the Conference Board Global Corporate Governance Research Center recommended that Committees consider independence from management as "the crucial question in selecting and using compensation consultants."[4] For many firms, executive compensation consulting is only one of an array of products and services which it provides to the corporation. If an executive compensation

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[3] See Proposed Item 402 (b). See GORDON *supra* note 1, at 116.
[4] Carolyn Kay Brancato and Alan A. Rudnick, *The Evolving Relationship Between Compensation Committees and Consultants*, The Conference Board Global Corporate Governance Research Center, January 2006, available at www.conference-board.org

consulting firm is part of such an organization, disclosure of any affiliates that also provide services to the company is necessary.

Currently, major compensation consulting firms can easily have conflicts, thus impairing the independence of their compensation advice, for reasons as follows:

> (i) Of the largest consulting firms in the U.S., only one provides only compensation consulting services. All others provide a multitude of HR-related consulting services and some also provide insurance brokerage services or IT outsourcing services either directly or through affiliates (collectively referred to as "Diversified Consulting Firms").
>
> (ii) Compensation consulting makes up a very small percentage of revenue for most Diversified Consulting Firms providing compensation consulting services.
>
> (iii) It is general knowledge in these Diversified Consulting Firms that they want to sell other services in addition to compensation consulting. This approach involves "cross-selling" and many points of contact within an organization (almost all with management).

The combination of these factors leads to a situation where the compensation consultant is obviously beholden to management and is subject to various types of pressure to satisfy management. The authors of the Conference Board report liken this to the situation between audit committees and outside auditors prior to the Sarbanes-Oxley Act:

> The Act, as implemented, mandates that independent audit committees control this relationship by making them solely responsible for the hiring, firing, compensation, and monitoring the independence and performance of the outside auditors…These limitations have strengthened the integrity of the outside audit by effectively eliminating economic incentives for the auditors to curry favor with management to preserve and expand lucrative non-audit consulting contracts, rather than focusing all efforts on the independent audit and audit-related services. Compensation committees can find themselves in an analogous position if their consultants stand to profit more from the work performed for management, rather than services provided to the committee. (Page 15)[5]

Another analogy can be seen in the case of investment banks providing investment research advice. In both cases, there was supposedly a "Chinese Wall" of well intentioned professionals who were looking out for the interests of all concerned to prevent conflicts of interest. We all know how that turned out. Scandals and poor judgment wreaked havoc on the accounting profession as well as the investment banking profession[6]. A similar set of circumstances surrounds the compensation consulting

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[5] Id page 15.

[6] John Goff, *Wall? What Chinese Wall?,* Apr 22, 2002, CFO.com. See also Ariel Markelevich, Charles A. Barragato, and Rani Hoitash, *The Nature and Disclosure of Fees Paid to Auditors: An Analysis Before and After the Sarbanes-Oxley Act*, The CPA Journal Special Edition November 2005, available at http://www.nysscpa.org/cpajournal/2005/1105/special_issue/essentials/p6.htm

profession today. In our view, the SEC must take action to shed light on this issue and improve the independence of Committee operations.

Diversified Consulting Firms admit that "cross-selling' is an objective between HR consulting and other parts of the firm.[7] This is especially prevalent when selling services to Fortune-100 firms, as shown by Affiliated Computer Services in their earnings discussion after acquiring Buck Consultants.[8]

To highlight the point of the diversification of firms that provide compensation consulting, additional HR services and other types of services, we have constructed a chart that is a companion to Chart 1 at end of this letter.

Firm	***Services Provided Other Than Compensation Consulting***	***% of Overall Revenues Made up by HR Consulting***
Affiliated Computer Services, Inc. (Buck Consultants, Inc.)	Business Process Outsourcing HR Consulting* IT Consulting Systems Integration	13%
Aon Corporation	HR Consulting* Risk and Insurance Insurance Underwriting	12%
Clark, Inc.	HR Consulting* Banking Executive Benefits Healthcare Federal Policy	12%
Hewitt Associates, Inc.	HR Consulting* Outsourcing	28%
Mercer, Inc.	HR Consulting* Retirement Management and Organizational Change Healthcare/Group Benefits Economic	14%
Watson Wyatt Worldwide, Inc.	HR Consulting* Benefits Technology Solutions	8%

Source: Hoovers.com

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* Includes other than compensation consulting services, such as pension, health & welfare, communications, etc.

[7] ACS Q1FY06 Earnings Release Slides dated October 20, 2005, which can be located at http://www.acs-inc.com/invest/q1fy06_earningsslides.pdf

[8] Id. Slide #10

It is clear that HR consulting is not the primary source of revenue at these companies. More importantly, the revenue derived from compensation consulting is a fraction of total HR consulting revenue. For example, for a typical HR consulting firm, compensation consulting revenue will be about 3% to 10% of total HR consulting revenue. Using this estimate, we estimate compensation consulting revenue to be between .5% and 2% of total firm revenue. In other words, all other revenue completely overwhelms the compensation consulting revenue and calls into question the independence of their compensation-related advice.

Since compensation consultants or any HR-related consultant are not bound by a credible code of ethics that will affect their ability to practice, there is no real impediment for a compensation consultant to bend towards management. In fact, there are many cases where a compensation consultant was fired, demoted or re-assigned when they did not go along with management or at least did not enthusiastically support management's demands. Thus, the situation provides extreme economic pressure to bend to management without a corresponding code of ethics or something else to resist this pressure.

To ensure that disclosures are complete and provide shareholders with all relevant information as to advisor independence, we advocate that the CD&A should include a table showing the fees paid to the advisor and its affiliates. This approach would be analogous to and consistent with disclosure requirements for a corporation's independent auditors.

An example of what this table might look like is shown below. The table should show (i) the fees paid for Compensation Committee consulting services and (ii) aggregate fees paid by the Company for all services performed by all entities in the company of which the consulting unit is a part. Along with attesting to the accuracy of their pay decisions, Committee members, by signing the CD&A with a table of outside advisor fees, will attest to the independence of the process in determining compensation programs and amounts.

The following table would help to clarify the independence of Committee advice:

Compensation Advisor Fees	$ XX,XXX
All other fees paid to Compensation Advisor and Affiliated Companies	$XXX,XXX,XXX
Total	$XXX,XXX,XXX

The term "Compensation Advisor" refers to the firm providing compensation consulting services and all other affiliated companies. The shareholders may be shocked by the amounts some companies are (a) paying their Compensation Advisor (may be in millions of dollars) and (b) total fees for all services (may be close to $100 Million in certain cases where all HR services are being provided to large, global companies). The amount paid would also give an indication to the amount of work that went into the review of the executive compensation program.

This chart is similar to that included in the Audit Committee Report. This would provide a snapshot of the independence of compensation consulting advice. This small change would compel Committees to review their Compensation Advisor and their independence (or alignment with management).

As stated above, we would suggest that the law firm be named in the CD&A (or other advisors used by the Committee), but that the suggested fee disclosure apply to those firms whose advice pertained to setting pay and pay techniques, which are typically limited to executive compensation consultants.

Affordability of Compensation Advisors

Some have said that that two consultants or advisors (or in some cases three if the Committee engages legal counsel) will be costly. At the same time, it is clear that a large part of shareholder value is being paid to management and employees in general in compensation and benefits. While the Committee does oversee many aspects of the compensation and benefits, it really gets very involved in the design and payout from the Company's incentive plans. Moreover, executive pay amounts to executive officers have increased by 9.4% each year over the past ten years.[9]

In a typical Fortune 100 company, approximately 1% to 1-1/2% of market capitalization is paid out in short- and long-term incentives with a substantial portion paid to its executive officers. Using an average market capitalization of $25 billion as an example, the annual incentive pool (annual bonus plus long-term incentive awards) could be in the range of $250 million to $375 million. The Committee and other directors have an obligation to shareholders to make sure that this pool is created (e.g., incentive plan design), paid out in a proper manner and that the payouts are tied to corporate performance in a meaningful way. With such large amounts at stake, it seems foolish not to require that the Committee hire its own advisors, after a rigorous assessment of their independence from management.

In our view, it is extremely important that (a) the Compensation Advisor provide no other work to the company unless it is closely related to their advice and no other firm can accomplish the task in a reasonable time and cost and (b) the Committee keep a short leash on the Compensation Advisor by requiring a detailed engagement letter be entered into and close scrutiny of interaction with management be maintained.

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[9] Lucian Bebchuk and Yaniv Grinstein, "*The Growth of Executive Pay,*" Harvard Olin Center, Working Paper No. 510/2005 as revised for publication in 21 Oxford Review of Economic Policy 283-303 (2005), available at http://ssrn.com/abstract=648682, 3.

Review of Commentary on Independence of Compensation Consulting Advice

In the past three years, there has been a substantial amount of commentary attesting to the importance of independent compensation consulting advice to aligning executive pay with corporate performance. We summarize these documents below, from A to F, beginning with the groundbreaking "Restoring the Public Trust" in January 2003 and ending with a March 2006 article in the New York Times questioning the independence of compensation consulting advice.

A point to note is that the Conference Board may have reversed its position on the issue of independent compensation consulting advice. In September 2005, a Conference Board report by a working group composed of human resource executives and compensation consultants (and one corporate governance expert who dissented from the working group's report) suggested that a single consultant could avoid "non-constructive behavior" by using the firm's Diversified Consulting Firm as their compensation consultant so as to not "deprive the Company of the firm's talents."[10]

In January 2006, in a subsequent report focusing on compensation committees' processes to ensure independence and objectivity of outside advice, the Conference Board report states "When the committee hires a consultant only for itself, and the consultant has not historically done work for the company or its current management, the committee can easily assure itself about independence."[11]

In his aforementioned working paper, Professor Jeffrey Gordon describes the "faulty governance story" that authors Lucian Bebchuk and Jesse Fried outline in their thought-provoking book, *Pay Without Performance: The Unfulfilled Promise of Executive Compensation*. Clearly it can be seen that the "use of compensation consultants with disabling conflicts of interest, in particular, provision to the firm of a wide range of compensation consulting services" is a main factor in the "faulty governance story".[12]

Finally, there are connections between lack of independence and unusual pay arrangements as reported by the New York Times with regard to Northfork's very unusual pay programs.[13]

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[10] Charles Peck and Jude Rich for The Conference Board, *Executive Compensation Consulting, A Research Working Group Report on Best Practices,* September 2005, available at www.conference-board.org. 8.
[11] KAY BRANCATO and RUDNICK supra note 3, at 15.
[12] GORDON supra note 1, at 103.
[13] See Gretchen Morgenson's *Bank Deal's Payout Plan Questioned*, New York Times, March 15, 2006, Section C, Page 1, Column 6, electronic copy available at www.nytimes.com.

A. Commission on Public Trust and Private Enterprise. (Conference Board: January 2003)

In the *Commission on Public Trust and Private Enterprise* (sometimes referred to as "Restoring the Public Trust Report), the Conference Board considers it highly advisable for Compensation Committees to hire independent compensation consultants to ensure the objectivity of their executive pay recommendations. The report states "The committee needs to act independently of management, hire its own consultants, and avoid benchmarking that keeps continually raising the compensation levels of executives."[14]

B. Executive Compensation and the Role of the Compensation Committee. (National Association of Corporate Directors: December 2003)

The National Association of Corporate Directors ("NACD") set up a Blue Ribbon Commission ("BRC") to examine issues related to executive compensation and oversight of the executive compensation decision making process. The commission was made up thirty four people, four of which were compensation consultants. (I was on this panel.)

The BRC reported that Committees can work more effectively with the help of qualified professionals who are independent of management. For that reason, the BRC recommended that Compensation Committees consider engaging an independent compensation consultant, who does no work for management, to assist the Committee. The report suggested appointing an independent compensation consultant to assist in the development of a compensation philosophy and executive pay packages. It goes on to state "any consultant hired by management should not be engaged in assignments involving CEO or senior executive pay."[15]

The NACD believes that by separating the consultant's role from management, it eliminates possible confusion. They contend that if a consultant is hired by management, he or she might feel conflicted when making recommendations: "A consultant engaged by the committee is much more likely to take an objective view that is consistent with the board's responsibility to shareholders and other constituencies. This may result in a higher cost of board operations, but it can be an appropriate investment, considering the impact and magnitude of executive compensation."[16]

C. Executive Compensation Consulting: A Research Working Group Report on Best Practices (Conference Board: September 2005)

The Conference Board's "Executive Compensation Consulting: A Research Working Group Report on Best Practices," focused on guidelines for committees, HR managers and advisors. It is important to note that the majority of those who compiled this report were representatives from large Diversified Consulting Firms. One of their main

[14] The Conference Board Commission on Public Trust and Private Enterprise, January 2003, page 6. available at www.conference-board.org.
[15] National Association of Corporate Directors Blue Ribbon Commission, *Executive Compensation and the Role of the Compensation Committee*, 2003, 18.
[16] Id 19.

arguments was: “The consultant (the individual and the firm) should be allowed to do other work for the company. Since many consulting firms provide services other than executive compensation, the company would be deprived of the talents of these firms.”[17] Judging from their claims, it is evident that their primary focus is not on independent decision making process for Committees and promoting maximization of shareholder value.

At the end of the working group report (Appendix C), Professor Charles Elson and Mr. Dan Lynch provide a dissenting view, arguing that this would impair the independence of committees. “First, I believe that the compensation committee, in most circumstances, should engage its own executive compensation consultant separate and apart from any such consultant working for management, given the current legal and regulatory environment in addition to public sentiment. Second, any such consultant engaged by the committee must agree to do no other work for the company other than the committee’s work so as to preserve the consultant’s actual and perceived independence from company management. These two points, I believe, are critical to enhancing the integrity and effectiveness of the executive compensation process in both fact and shareholder perception.”[18]

It is this view that prevailed as the Conference Board introduced another report just four months later in response to this dissension (see below).

D. Executive Compensation: If There’s a Problem, What’s the Remedy? The Case for “Compensation Discussion and Analysis,” Professor Jeffrey N. Gordon, Columbia Law School, The Center for Law and Economic Studies Working Paper No. 273/2006 forthcoming, Journal of Corporation Law (Created in September 2005, to be published in Summer 2006)

Jeffrey N. Gordon, professor at Columbia University Law School, provides the seminal argument for the CD&A, and also provides another necessary part to the process of setting executive pay, which is an independent Compensation Advisor.

Professor Gordon suggests that the Committee sign the CD&A report and advocates independence in the process of determining executive pay. Below are a select number of excerpts from Professor Gordon’s paper:

> “Various governance arrangements make it unlikely that the board will act as a good faith bargaining agent for the shareholders in an arm’s-length process.” (Page 103)[19]
>
> [One of the salient elements in the faulty governance story is the] “use of compensation consultants with disabling conflicts of interest, in particular,

[17] PECK and RICH supra note 8, at 8.
[18] Id at 3.
[19] GORDON supra note 1 at 103

> provision to the firm of a wide range of compensation consulting services." (Page 103)[20]

> "Drawing from new practices of audit committees influenced by Sarbanes-Oxley…compensation committees may well insist on independent compensation consultants and perhaps independent counsel…board process is likely to improve considerably…these process improvements could make a significant difference in compensation policies." (Page 120)[21]

E. "The Evolving Relationship Between Compensation Committees and Consultants" (Carolyn Kay Brancato and Alan A. Rudnick for the Conference Board: January 2006)

This Conference Board report resulted from an array of dissenting views on guidelines and arguments made in the Working Group report mentioned previously. Importantly, it addressed the questions raised about compensation consultants who provide other services directly to management and also discussed the advantages to hiring independent advisors.

This report concluded that "when the compensation committee uses information and services from outside consultants, it must ensure that consultants are independent of management and provide objective, neutral advice to the committee. At a minimum, the committee must control all aspects of the committee-consultant relationship, including consultant retention, the scope of work, oversight and monitoring of work, and if necessary, dismissal of the consultant."[22]

The report emphasizes that compensation committees must assure themselves of consultants' independence from management.

> "Directors must be able, in good faith, to conclude that advice they receive from consultants is unvarnished and responsive to the issues before the committee. Unless directors are satisfied that the consultants are independent and provide objective advice, directors risk impairing their own independence and thus violating their fiduciary duties." (Page 15)[23]

Another main finding in the recent Conference Board report, is that a good way to determine the independence of the consultants is by scrutinizing how much they are being paid for compensation and other services that they provide.

> "Any imbalance in fees generated by management versus fees generated on behalf of the committee should receive intense scrutiny." (Page 15)[24]

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[20] Id at 103.
[21] Id at 120.
[22] KAY BRANCATO and RUDNICK supra note 3, at 6.
[23] Id at 15.
[24] Id at 15.

In remarking on the role of professional advisors in the pre-Sarbanes-Oxley era, of companies, this Conference Board report found as follows:

> "various professional advisors of companies, such as public auditors, compensation consultants, and, in some cases, law firms, failed to provide truly independent advice and professional judgment as they came to view management as the 'client' instead of the corporation." (Page 21)[25]

F. "Bank Deal's Payout Plan Questioned" (New York Times; March 15, 2006)

Pulitzer-Prize winning journalist, Gretchen Morgenson, wrote an article in the NY Times on March 15, 2006, addressing escalating concerns about the executive pay recommendations made by Mercer HR Consulting to North Fork. The thrust of her argument was as follows: "When the same consulting firm that advises a board on pay practices generates revenue by providing other services to the company, questions can arise about which master the consultant is serving."[26]

In addition to advising on pay matters, many large compensation consulting firms, including Mercer, Hewitt, and Watson Wyatt, also provide other services to companies, like actuarial and outsourcing services and pension plan administration. "Mercer earned a total of almost $1 million in 2002 and 2003 for its services as actuary to North Fork's cash-balance retirement plan."[27]

Paul Hodgson, a senior research associate at the Corporate Library, contends, "We like clear lines of distinction in corporate governance because you avoid the possibilities of anyone raising a red flag saying, wouldn't the consultant be worried about losing their contract with the HR department if they came to the compensation committee and said we find the CEO is overpaid?"[28]

Accordingly, Committee advisors should have the ability to exercise independent judgment free from any relationship or influence that could appear to compromise their ability to approach compensation issues decisively and independently.

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[25] Id at 21.
[26] MORGENSON supra note 11.
[27] Id
[28] Id

Chart 1. Partial List of Diversified Consulting Firms[29]

Consulting Firm	Professional Services	% of Total Revenue	Total Revenue ($ mil.)
Aon Corporation	Risk and Insurance	56%	$5,696.3
	Insurance Underwriting	31%	$3,153.3
	Consulting (HR & Other)	12%	$1,220.6
	Other	1%	$101.7
			$10,172.0
Clark, Inc.	Banking	45%	$123.2
(Pearl Meyer)	Executive Benefits	22%	$60.2
	Healthcare	14%	$38.3
	Pearl Meyer (compensation only)	12%	$32.9
	Federal Policy	4%	$11.0
	Other	3%	$8.2
			$273.8
Hewitt Associates, Inc.	Outsourcing	70%	$2,022.7
	Consulting (HR)	28%	$817.6
	Adjustments	2%	$58.2
			$2,898.5
Mercer, Inc.	Retirement	44%	$1,350.8
	Management and Org. Change	19%	$583.3
	Human Capital (HR)	14%	$429.8
	Healthcare and Group Benefits	13%	$399.1
	Economic	5%	$153.5
	Other	5%	$153.5
			$3,070.0
Watson Wyatt Worldwide, Inc.	Benefits	63%	$464.6
	International	13%	$95.9
	Technology Solutions	10%	$73.7
	Human Capital (HR)	8%	$59.0
	Other	6%	$44.2
			$737.4
Towers Perrin	***Human Consulting Services (HR)***		N/A
	Reinsurance		N/A
	Tillinghast		N/A
			$1,620.0
Affiliated Computer Services, Inc.	Business Process Outsourcing	75%	$3,238
(Buck Consultants, Inc.)	***Buck Consultants, Inc (HR).***[30]	13%	$640
	IT Consulting	17%	$859
	Systems Integration	5%	$254
			$4,991

[29] Source: Hoovers.com. Segment that provides compensation consulting services is show in bold italics.
[30] Revenue listed for Buck Consultants is based on ACS Q1FY06 Earnings Release Slides dated October 20, 2005, which can be located at http://www.acs-inc.com/invest/q1fy06_earningsslides.pdf.

Attachment C: How ‘Independent’ is Your Compensation Advisor” (The Corporate Board: March/April 2008) (under separate cover)

Attachment D: Study entitled “Executive Compensation Trends for 2009: Balancing Risk, Performance and Pay” (under separate cover)

How "Independent" Is Your Compensation Advisor?

by James Reda

With shareholder (and election year) outrage over top executive pay at a new peak, board compensation committees must put increasing faith in the numbers and advice they receive from executive pay consultants. Yet research finds that many of the big compensation consulting firms suffer from the same independence and conflict of interest issues that roiled major auditing firms earlier in this decade.

Shareholder confidence and public patience continue to erode over the situation with CEO and top executive pay. In the past few years, headlines were made by executives who walked away with hundreds of millions of dollars in severance pay despite dramatic stock losses and poor performance overall. This begs the question of how these pay-for-failure arrangements were initially conceived or approved by the compensation committee of the board of directors.

Of course, concern over executive pay is hardly a new phenomenon. These days, however, the outrage has reached levels no director can afford to ignore. Compensation committee members must take a hard look at pay levels and continually reassess their processes and operations from start to finish.

Though there are evolving best practices, including pay-for-performance, the difficulty of board members' work is that there is not one "right" compensation level or philosophy that works for all companies at all times. Therefore, committee members seek outside expertise from consultants to provide them with a view of competitive market levels of executive pay, and to review all aspects of executive compensation. These include base salaries, annual cash incentives or bonuses, long-term incentives, and stock awards.

From a shareholder's point of view, the question remains, "Despite this additional expertise, are executive pay decisions being made within a truly independent process?" The choice of consultant for a compensation committee is an important one in the eyes of shareholders.

Compensation consultants who are retained to provide unbiased advice on executive pay offer a variety of services to the committee, such as:

☐ Benchmarking total compensation (salary, bonus, long-term incentives, perquisites and benefits).

☐ Designing employment agreements.

☐ Assisting with tax, accounting, and SEC implications of incentive plan design.

☐ Evaluating the CEO, other senior executives and the board.

☐ Designing deferred compensation, supplemental executive retirement programs (SERPs), and other executive perquisite and benefit programs.

☐ Designing change-in-control and severance programs.

☐ Providing corporate governance advice on executive and board pay.

☐ Advising on all other executive compensation matters.

The board's compensation consultants may have conflicting economic interests if they provide advice detrimental to management's payday.

Although compensation consultants are hired as independent advisors, it has been suggested by many (myself included) that the traditional providers of pay consulting services are influenced too heavily by management. This can lead to a situation where

James Reda *is founder and managing director of James F. Reda & Associates compensation consultants. [www.jfreda.com]*

the compensation committee may have little to no control over the negotiations that they are responsible for overseeing.

These consultants may have conflicting economic interests if they provide advice that is detrimental to management's payday, which may result in adverse economic consequences to the consultant or the consultant's firm.

Like the audit firms before Sarbanes-Oxley, traditional providers of compensation advice, referred to as "diversified human resources consulting firms," have significant economic incentives to provide additional services. These added services are oftentimes more lucrative, and include business process outsourcing, information technology consulting, risk and insurance underwriting, and actuarial consulting.

Consider for a moment, if the firm providing advice to the board on CEO and HR director pay also provides other services to the CEO and HR. How can the board ensure the firm's recommendations are independent and objective?

Even if a consultant is not providing other services to management—but has the potential to do so—the public still perceives a conflict.

According to the 2003 Blue Ribbon Panel of the National Association of Corporate Directors, in order for a consultant to be truly independent, that consultant "should be hired by and report directly to the [compensation] committee, and should not be retained by the company in any other capacity."

This advice has also been repeated by the Business Roundtable, Conference Board, New York Stock Exchange, prominent legal experts (practicing attorneys as well as academics), Chancellery Court of Delaware, institutional investors and institutional investor advisory firms.

Even if the consultant is not providing other services to management but has the potential to do so, the public still perceives a direct conflict-of-interest and lack of independence. Public policy makers, public and private oversight bodies, and shareholder groups continue to focus on enhancing the ability of corporate boards to ensure the businesses operate ethically and effectively. Best practices have been encouraged by professional associates and new rules have been developed.

As of August 2006, publicly traded companies must disclose the identity and the nature of the assignment of their compensation consultants to the Securities and Exchange Commission. In a letter to the SEC in April of 2006, during the discussion of proposed regulation changes, I recommended that the SEC require further disclosure on compensation advisor independence. However, the final requirement stopped short of disclosing what (if any) other services the consultants provide to the company and also the fees charged for the executive pay consulting or fees charged for other services.

In October 2006, the Connecticut State Treasurer and the AFL-CIO joined 11 other institutional investors in writing letters to the 25 largest U.S. companies, requesting that they exceed the SEC's disclosure requirement on compensation consultant independence.

Also in 2006, Representative Henry A. Waxman, as Chair of the Congressional House Oversight Committee, ordered an examination of whether the compensation consultants hired by large publicly traded companies act independently. In 2007, the Oversight Committee requested that each consulting firm report fees paid for consulting services and for all other services.

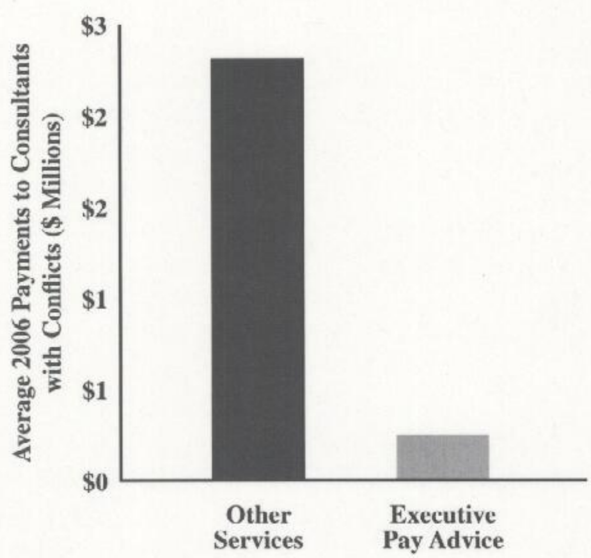
This examination collected information from the six top consulting firms about their work for the 250 largest publicly traded companies over the five-year period of 2002 through 2006. For the first time, a review of the fees paid and a study on the impact of such fees on executive pay levels was done.

A hearing of the House Committee on Oversight and Government Reform was called in December 2007, and the report, *Executive Pay: Conflicts of Interest Among Compensation Consultants,* was released. The report found that:

☐ Compensation consultant conflicts of interest are pervasive.

☐ The fees earned by compensation consultants

Where The Money Is
Is Executive Pay Advice A Loss Leader?



for providing other services often far exceed those earned for advising on executive pay.

☐ Some of the consultants received over $10 million in 2006 to provide other services.

In 2006, over two-thirds of the Fortune 250 companies that hired "conflicted" compensation consultants did not disclose the conflict in their SEC filings.

Many Fortune 250 companies do not disclose their compensation consultants' conflicts of interest. In 2006, over two-thirds of the Fortune 250 companies that hired "conflicted" consultants did not disclose the conflicts in their SEC filings. In 30 instances, the companies informed shareholders that the compensation consultants were "independent," when in fact they were being paid to provide other services to the company.

There appears to be a correlation between the extent of a consultant's conflict of interest and the level of CEO pay. According to the report, the fees that consulting companies earned for services other than providing advice on executive pay far exceed the fees earned for compensation consulting.

Specifically, the report stated that in 2006, consultants who provided both compensation consulting services and other services to Fortune 250 companies received an average of $220,000 for executive pay advice and $2.3 million for other services from each client company.

Furthermore, the report found an apparent correlation between CEO pay and hiring compensation consultants with significant conflicts of interest. According to the report, CEOs were paid a median salary of $12.5 million in 2006 at the major companies using compensation consultants with the largest conflicts (as measured by fee ratios). This was 67 percent higher than the median salary of $7.5 million paid by companies that did not report using consultants with conflicts of interest.

The report admits that the correlations only suggest a possible relationship between CEO pay and conflicts of interest. Many other factors may contribute to the salaries paid to CEOs at Fortune 250 companies.

The four diversified human resources consulting firms surveyed maintain that "a consulting firm's ability to provide objective, independent advice regarding executive pay is not compromised simply because it provides other services to the company." These firms described policies and practices that are followed to make sure that compensation committees receive unbiased advice.

One such practice that large diversified HR consulting firms talk about is the creation of "walls" that they say ensure independence of consulting advice. However, the economic interest that ties consultants together is difficult to overcome. These include ownership interests in the common firm, overhead expense (rent, administrative support, etc.) and, most importantly, cash pay.

It only makes sense that the more a consulting firm earns, the more valuable it will be for their owners and the more it can pay its senior members. A compensation consultant will always consider their overall economic interests. Consultants that do no other business with the company will have no concern about management's attitude towards their company with regard to other types of business.

Compensation committees should file disclosures similar to those that have proven crucial in making the audit process independent of management.

As part of my testimony to the House Committee on Oversight and Government Reform, I urged disclosure to verify the independence of the compensation advice boards receive from consulting firms. This disclosure would be similar to that found in the audit committee report, so crucial in making the audit process independent of senior management. Such an added disclosure could help remedy the negative perception executive compensation holds with shareholder groups, the public and the media.

Recommended disclosures would include:

☐ The procedure the compensation committee follows in choosing a compensation consultant and a declaration by the committee identifying its position on the degree of independence of its executive pay consultant.

☐ A table presenting fees paid to compensation consultants for pay consulting services and all other fees paid to the consultants' firm or affiliated firms for other services.

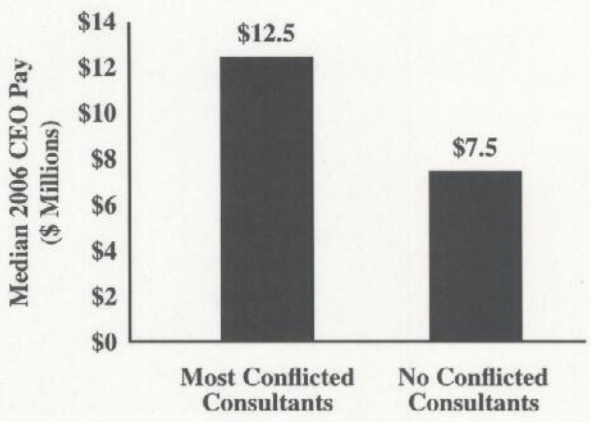
☐ The type of work performed by the consultant.

☐ The relative fee structure for work performed for the compensation committee and for management, if applicable.

Additionally, the committee should provide a description of the type of work performed when the consultant works with management.

Having identified this potential for a conflict-of-interest and the demand for objective, independent compensation advice, there are a growing number of *independent* firms made up of experts that formerly worked at large diversified HR firms. These independent experts continue to offer pay advice, but without any potential or perception for conflict of interest.

Paying For Results?
Consultant Conflicts Lead To Big CEO Paydays



Independent consultants provide about 20 percent of the executive compensation consulting performed in the U.S. This percentage is expected to increase as boards decide on the independence of their executive compensation consulting.

One argument against using an independent is that they are not "full-service" consultants in that they do not provide actuarial, communications, health and welfare, and tax and legal advice. The compensation consultant need not have offices in multiples countries, or offer other services. These may be provided by either the company or other consulting, legal or accounting firms. In most cases, the compensation committees of large companies oversee U.S.-based executives that do not require other country knowledge.

Major companies, including Wachovia, Pfizer and Verizon, now have written policies that prevent pay consultants from doing any other work for the company.

Some companies are starting to take action by moving to independent compensation advisors. For example, Wachovia, Procter & Gamble, Pfizer, Verizon and others have written policies that prevent pay consultants from performing any other type of work for the company.

In my view, boards need to consider the following criteria when seeking outside advice for executive compensation:

☐ *Independence from management.* Advisors engaged solely by the board are more likely to provide objective advice consistent with the board's responsibility to shareholders.

☐ *Industry expertise.* This expertise should include a solid understanding of the overall industry in which the company is engaged, its competitive market forces, key dynamics that influence individual company and overall industry performance, and the competitive talent pools.

☐ *Direct and relevant experience.* Advisors should be highly experienced and have successful track records in assisting similar companies. Generally speaking, the prospective consultant should have several years of executive compensation consulting experience.

☐ *Executive compensation resources.* The firm should have an extensive survey library, data resources, and secondary consulting resources in the event that the lead consultant is not available.

☐ *Visibility and good reputation.* Particularly for large companies, the consulting firm and its lead consultants should be nationally recognized and well regarded.

☐ *Seamless integration of resources.* The lead consultant and consulting firm should be able to deliver, or arrange for, accounting, tax, actuarial, pension, and financial advice in a seamless manner.

☐ *Nationwide and worldwide coverage.* A company with internationally based executive officers should also look for international consulting capabilities

☐ *Proficiency with all pay elements.* The consulting firm and its consultants should have knowledge of salary; short-term and long-term incentives; and pension-benefit, welfare-benefit, employment, severance and change-in-control agreements and executive perquisite programs. A consultant who is not personally proficient in all elements should be able to recognize issues and access expertise in all such areas.

☐ *Business goals and executive pay strategy alignment.* The philosophy of the consulting firm should be compatible with the company's philosophy. Some consultants have a specific philosophy and approach and may be reluctant to or unable to acknowledge the merits of a different but legitimate approach favored by the compensation committee. This would be a poor fit.

☐ *Performance measurement expertise.* The consultant must be expert at interpreting financial statements and correctly applying financial ratios and measures in light of the company's industry, business plan, and other pertinent facts and circumstances.

☐ *Creativity and capability to create custom designs.* The consulting firm should be able to provide creative solutions in the context of shifting economic trends and business models.

It is crucial for public U.S. corporations to implement executive compensation programs that truly pay for performance. Such programs will help improve our companies' credibility at home and abroad, and can help quiet the critics of executive pay, provide additional transparency to shareholders, and benefit American business.

Let the shareholders, compensation committee members and others that have an interest in the allocation of corporate resources be aware of potential conflicts associated with executive compensation consulting. ■

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Executive Compensation Trends for 2009:
Balancing Risk, Performance and Pay

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Introduction

There have been substantial changes reported by companies in their 2009 proxy statements following an unprecedented drop in stock prices. This study reviewed 200 of the largest companies (by market capitalization) that comprise the S&P 500 Stock Index. We reviewed "forward looking" statements with regard to changes in 2009, which is the focus for this study.

Surprisingly, 70 percent of companies reported changes to their 2009 executive compensation programs. These range from "minor changes" relating to salaries to "major changes" relating to short and long-term incentive programs. We also reviewed changes to severance, retirement and perquisites programs. In our study, we reviewed each proxy statement for a description of prospective changes for 2009 in response to the economic downturn and increased shareholder scrutiny.

Incentive compensation comprises the bulk of executive pay packages at publicly traded companies. Boards of directors and senior management are continually searching for the right performance measures to balance rewards with both financial and operational performance. It's a complex task, and the stakes have been raised.

In 2007, the SEC began requiring companies to disclose performance measures and goals related to executive pay programs. At the same time, many companies have been shifting the basis for their long-term incentive ("LTI") plans away from stock options to performance-based share plans.

The area of performance metrics includes multiple factors related to the alignment of pay and performance. These are crucial to the overall executive program design and should be included in the compensation philosophy. Some of the factors include:

- Changes to salary
- Performance measures
- LTI pay mix
- Amount paid in cash immediately or amount deferred (typically in stock)
- Pay for performance (minimum, target, and maximum)
- Severance pay
- Stock ownership guidelines

We included changes to salary and severance pay as part of performance metrics because there may be a disconnect between pay and performance. For example, an executive may receive a salary increase in the face of disastrous corporate results or get a large severance pay for failure.

Executive compensation program changes reported for 2009 appear to be primarily related to broad-based stock price drop from December 31, 2007 to February 28, 2009. The greater the drop in stock price, the more likely it is that a company reported a change to their program. This relationship also applies to each element of compensation.

To assist in our study, we categorized changes as "minor" or "major". Minor changes are related to adverse salary changes. Major changes primarily relate to short- and long-term incentive plans, but we have also included changes to severance, retirement and perquisite programs in this category as well.

Part I. Study Highlights

In general, incentive plans have changed as follows:

- A shift away from long-term incentives to include more focus on short-term incentive plans;

- Short-term incentive ("STI") plan performance measures shifted to profit and cash flow from capital efficiency;

- Long-term incentive plan performance measures shifted to capital efficiency, cash flow and total shareholder return; and

- Companies are increasing their emphasis on time-vested restricted stock ("RS") and restricted stock units ("RSUs").

Specifically, a substantial majority (70 percent) of companies that filed proxy statements disclosed changes to their executive compensation programs effective in 2009 that will impact pay levels reported in next year's proxy. Highlights of the changes are as follows:

- *Base Salary*: Eliminated merit increases for 2009 (43 percent) and froze or reduced base salaries for 2009 (13 percent);

- *Short Term Incentives*: Adjusted short-term incentive program (e.g., move to discretionary plans, changes to Pay for Performance Curve[1]);

- *Long Term Incentives*: Adjusted long-term incentive grants (e.g., awarding the same number of shares regardless of value, decreasing the value of awards, changing the mix of award types, and changes to Pay for Performance Curve) (39 percent); and

- *Other Elements of Compensation*: Changed various other elements of compensation (e.g., modifying change-in-control ("CIC") benefits, eliminating tax gross-ups on perquisites, reducing retirement benefits) (15 percent). Modified CEO's change-in-control benefits (e.g., reducing the severance multiple)[2] (4 percent).

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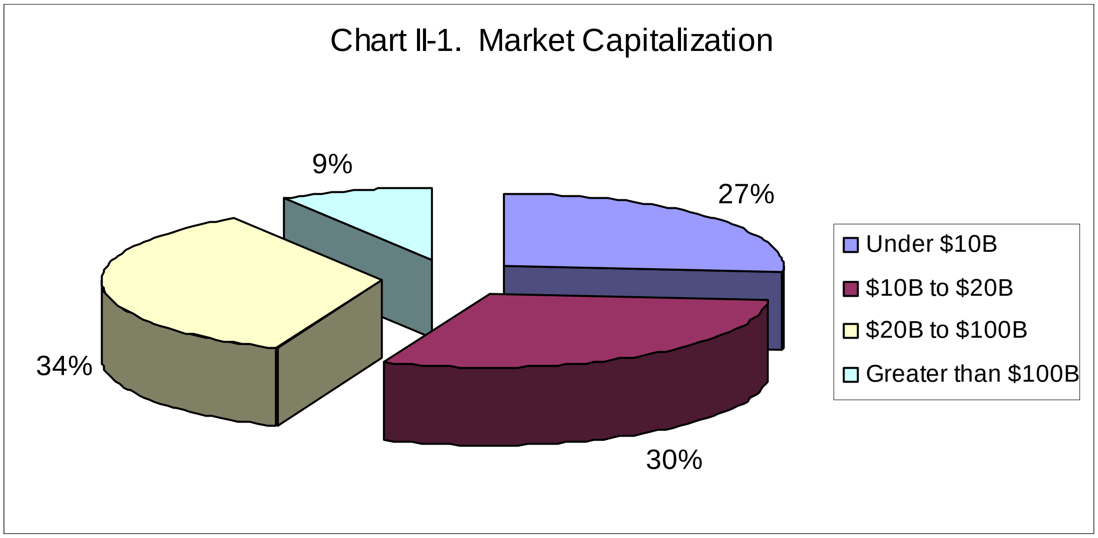
[1] Pay for performance curve ("Pay for Performance Curve") is the relationship between threshold, target or maximum performance levels and the corresponding threshold, target or maximum payout levels.

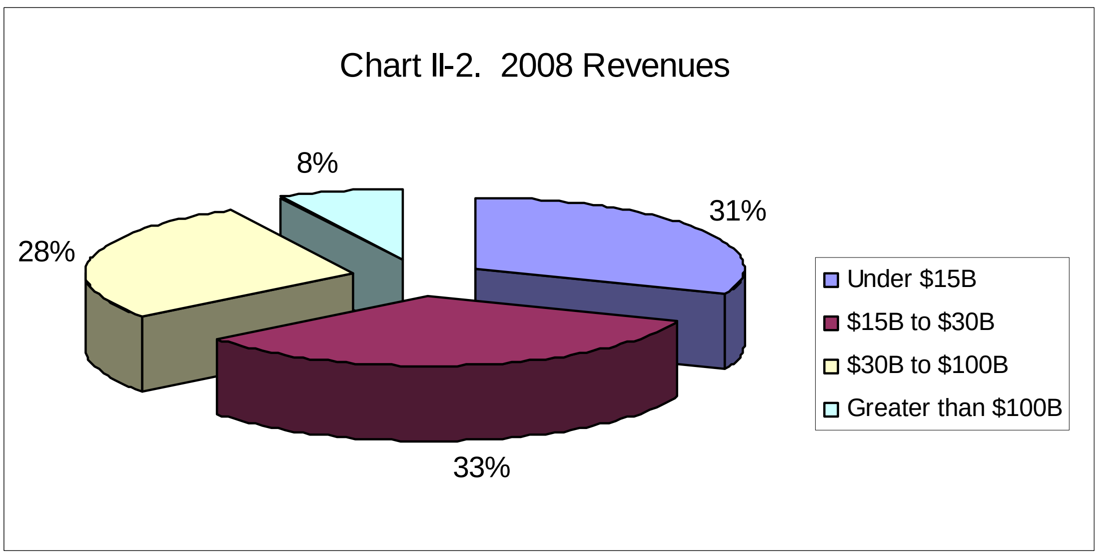
[2] Overall, there was no decline in the overall prevalence of gross-ups (full or modified), despite strong criticism of their use from some institutional shareholders and proxy advisory groups (e.g., RiskMetrics Group).

Part II. Approach and Methodology

Among the 200 largest companies (by market capitalization) of the S&P 500 Index, 191 companies filed proxy statements predominantly during the period February 1, 2009 through April 30, 2009 and before July 28, 2009.[3]

Below is a summary of the market capitalization, revenue and industry classification of the 200 companies chosen at the beginning of this study.





[3] 12 of the companies examined in this study have been part of the TARP (8 have already repaid TARP funds in 2009).

Chart II-3. Industry Breakdown

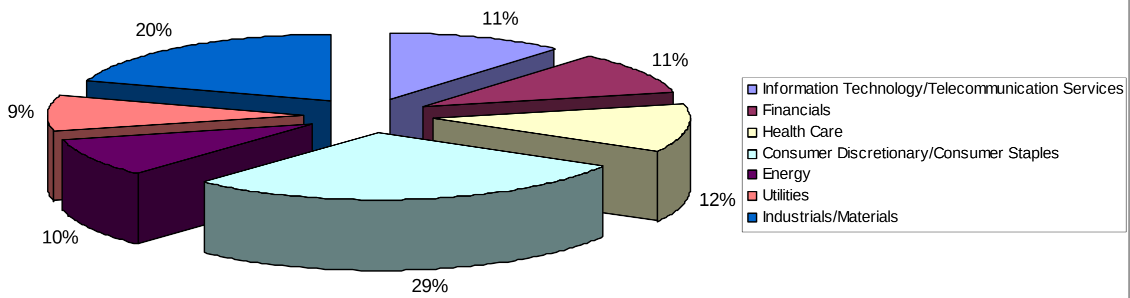
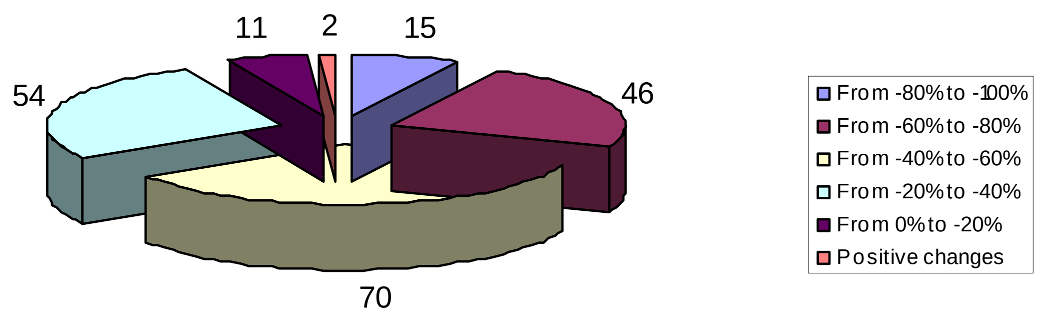


Chart II-4. Stock Price Changes
from 12/31/07 to 2/28/09
(198 companies total)



- General Motors (bankruptcy filing) and Philip Morris (not spun-off from Altria as of 12/31/07) are part of the 200 companies reviewed in this study but excluded from the stock price change analysis.
- Only two companies have experienced an increase in stock price (Amgen Inc and Walgreen Co).
- 70 companies had a stock price drop of between 40 percent and 60 percent.
- The median stock price change is negative 49 percent, or in other words, the typical company in this study lost about half of its value from 12/31/07 through the period leading up to the filing of the proxy statement.

For the purpose of this study we made a distinction between minor and major changes disclosed by 191 companies that have reported for 2009 (9 companies have yet to report by the effective date of this study). Because the typical mix of pay at the NEO level is skewed toward incentive compensation, we separated the changes with regard to the overall impact on total pay. Our categorization is as follows:

- "Minor changes" denote changes concerning base salary (e.g., freeze or reduction).
- "Major changes" relate to short- and long-term incentive plan changes as well as changes to severance, retirement and perquisite programs.
- No changes.

Part III. Findings

Overall, incentive trends can be summarized as follows:

- Overall, there has been a move away from long-term incentives and a shift toward short-term incentive plans,
- Short-term incentive plan performance measures shifted to profit and cash flow from capital efficiency,
- Long-term incentive plan performance measures shifted to capital efficiency, cash flow and total shareholder return, and
- Companies are emphasizing time-vested restricted stock and RSUs.

Specifically, 70 percent of companies that filed proxy statements by our deadline disclosed changes to their executive compensation programs effective in 2009 that will impact pay levels reported in next year's proxy. Highlights of the changes are as follows:

- Eliminated merit increases for 2009 (43 percent)
- Froze or reduced base salaries for 2009 (13 percent)
- Adjusted long-term incentive grants (e.g., awarding the same number of shares regardless of value, decreasing the value of awards, or changing the mix of award types) (39 percent)
- Adjusted short-term incentive program (e.g., moving to discretionary plans, widening payout ranges/decreasing thresholds, decreasing maximums) or applying negative discretion for bonus payouts (25 percent)
- Changed various other elements of compensation (e.g., changing CIC benefits, eliminating tax gross-ups on perquisites, reducing retirement benefits) (15 percent)
- Modified CEO's change-in-control benefits (e.g., reducing the severance multiple)[4] (4 percent)

Who is Changing their Executive Compensation Program?

As you may expect, companies who experienced large stock price drops tended to report changes to their executive compensation program, particularly regarding salary freezes and salary reductions as well as changes to incentive plans. Accordingly, 70 percent of 191 companies have reported changes for 2009. These changes are closely related to the overall drop in stock price, particularly for companies experiencing an approximate 50% or greater decline in value.

Chart III-1. Overview of Incident of Change

	No. of Companies	Percent of Companies
Companies that have reported in 2009	191	100 percent
No changes reported	57	30 percent
Minor changes reported (base salary)	94	49 percent
Major changes reported (short-term and long-term incentive plans, severance, perquisites and retirement plans)	108	57 percent
Companies that have reported changes	**134**	**70 percent**

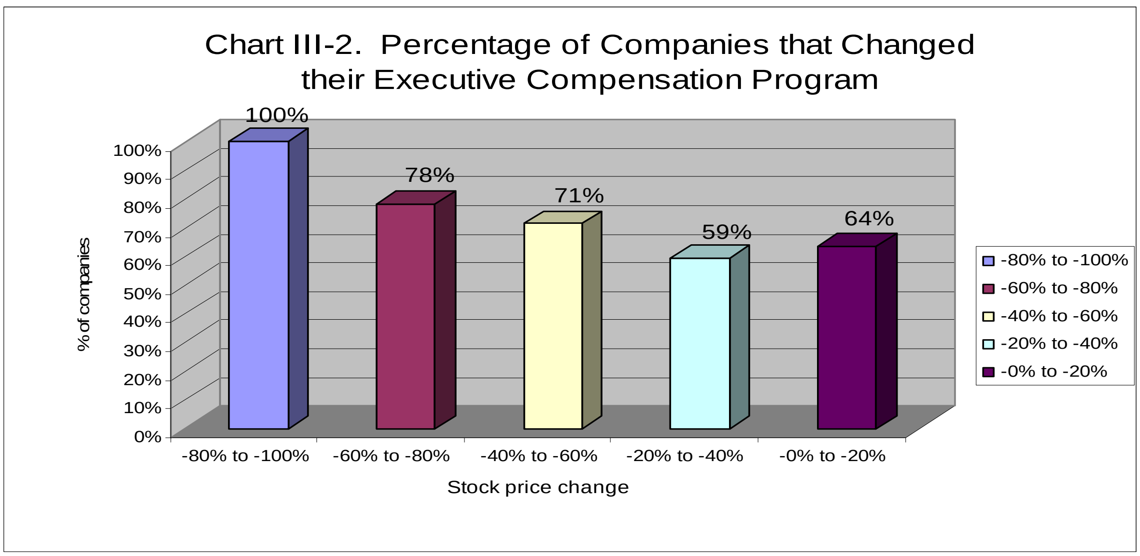
[4] Overall, there was no decline in the overall prevalence of gross-ups (full or modified), despite strong criticism of their use from some institutional shareholders and proxy advisory groups (e.g., RiskMetrics Group).

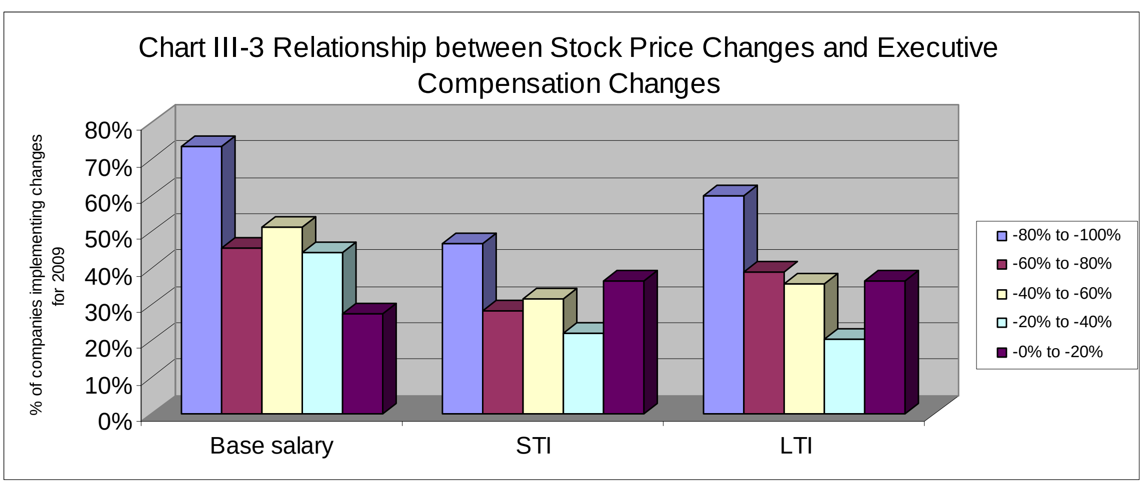
According to our study, 108 (57 percent) companies have reported a major change for 2009. This seems to show that the majority of large companies disclosed their intentions for the next year's executive compensation even though it is not clear that the SEC rules require disclosure of prospective changes.

Companies are most likely underreporting 2009 executive pay actions. This data suggests a selective nature of the disclosure as it is not clear if the Securities and Exchange Commission requires prospective disclosure on plans and programs. The 30 percent of companies that reported no changes to their programs may be misleading, particularly given the dramatic nature of the decline in the economy which began in the fall of 2008 and continued through the proxy filing season.

Relationship between Drop in Stock Price and Changes to Executive Compensation Programs

All companies with catastrophic stock price drops (more than negative 80 percent) made changes to their executive compensation programs in 2009. This trend of changing compensation programs lessens with smaller stock price drops.





What Do the Changes Look Like?

There are five elements to compensation, which are as follows:

- Base salary, including cost of living, merit and promotional increases;
- Short-term incentives, including changes to Pay for Performance Curve, performance measures, and forms of payout;
- Long-term incentives, including changes to Pay for Performance Curve, performance measures, and types of programs;
- Benefits and perquisites, including basic benefits, SERPs, retirement, personal use of aircraft, financial counseling and other excess benefit plans; and
- Severance, including severance with or without a CIC, death, disability and other.

For this study, we categorized changes to base salary as minor and all other changes as major.

Changes to Base Salary

This category of change only includes base salary. Approximately one-half of all companies reduced or froze salaries or eliminated merit increases with regard to base salaries (49 percent). A breakdown of changes to salaries is as follows:

- Eliminated merit increases for 2009 (43 percent),
- Froze salaries (7 percent), and
- Reduced executive salaries with a median salary cut of 10 percent (6 percent). Of these 12 companies, 8 applied the cut to all the top-executives (typically, the "Named Executive Officers") and 4 applied it to the CEO only.

Changes to Incentive Plans

In our study, we categorized three different types of major changes:

- Changes to the STI Plan (25 percent) including changes to performance measures, goals, target bonus opportunities and pay for performance curves,
- Changes to the LTI Plan (39 percent) including changes to LTI mix, performance measures, grants, cash plans, performance periods or goals, and
- Changes to severance, perquisites or retirement plans (15 percent).

Overall, there has been a shift away from long-term incentives and more focus on short-term incentive plans.

While performance measures have been emphasized in short- and long-term incentives, the LTI incentive has been substantially reduced, resulting in a larger percentage of compensation associated with the short-term incentive plan. The reasons for this shift are three-fold:

- More focus on short-term cash flow,
- More variability and less predictability for longer-term financial results, and
- The difficulty to provide the same LTI incentive value in 2009 when the stock price has been cut in half while the STI target value has remained about the same as 2008.

Changes to Short-Term Incentive Plans

One-fourth of all companies changed their STI plan in 2009. A summary of these changes is as follows:

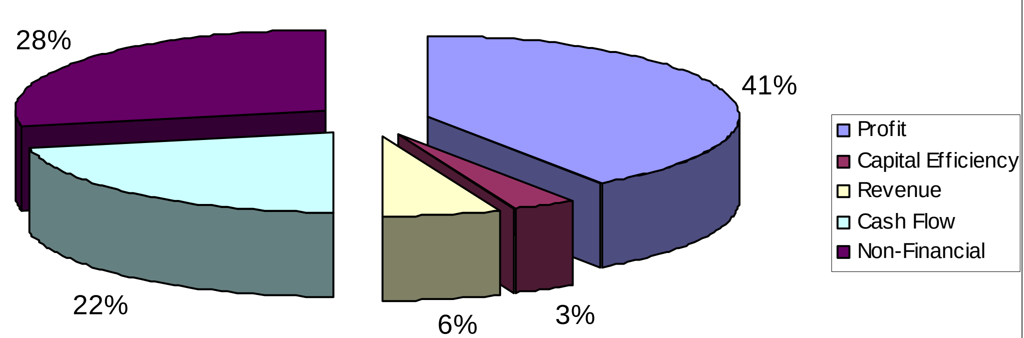
- Changed the weights of their performance measures (13 percent). The emphasis on STI performance measures was increased 32 times and decreased 22 times for a net increase in emphasis of 10. (See Chart III-4.)
- Other modifications to their STI plan such as changes to (i) target bonus opportunities or (ii) to the pay for performance curve (10% percent).
- Introduced intermediate or mid-performance period goals (2 percent).
- Cancelled the STI plan for 2009 (one company or less than 1 percent).

The importance of short-term incentive performance measures is shown in the number of weight changes planned for 2009. The results also show that profit and cash flow measures increased by an aggregate of 15.

Chart III-4. Changes in STI Performance Measures

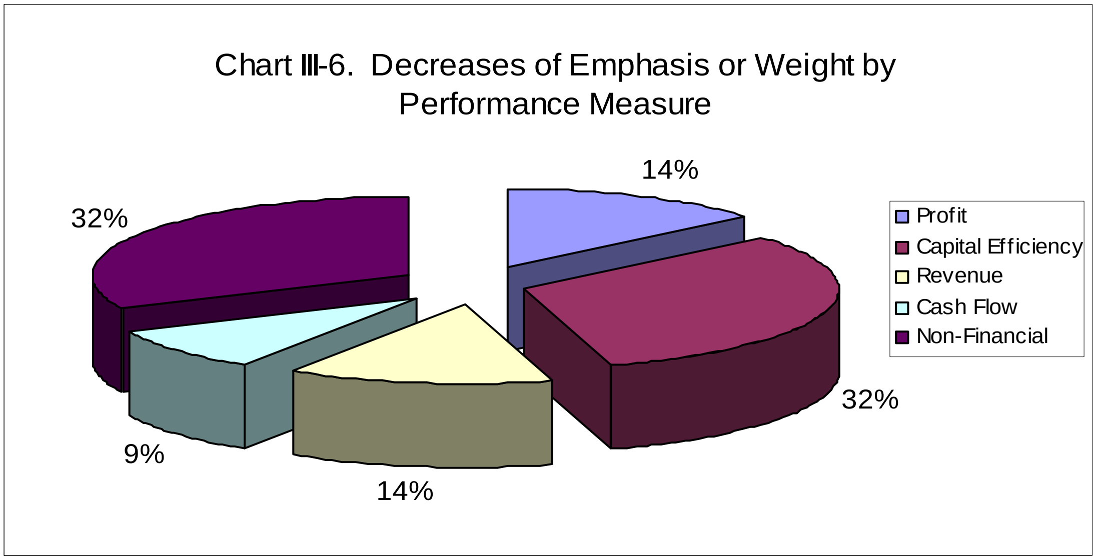
	Changes to Weight or Emphasis		
Performance Criteria Type	**No of Reported Increases**	**No of Reported Decreases**	**Net Changes**
Profit: Earnings per share, net income, EBIT/EBITDA, pretax profit, operating income.	13	3	10
Cash Flow: Cash flow, cash flow growth	7	2	5
Non-Financial: Strategic goals, individual goals, liquidity, market share, overall performance of the company, team incentive.	9	7	2
Revenue: Revenue, revenue growth	2	3	-1
Capital Efficiency: Return on equity, return on capital, return on net assets, return on invested capital, economic value added	1	7	-6
TOTAL	32	22	10

Chart III-5. Increases of Emphasis or Weight by Performance Measures



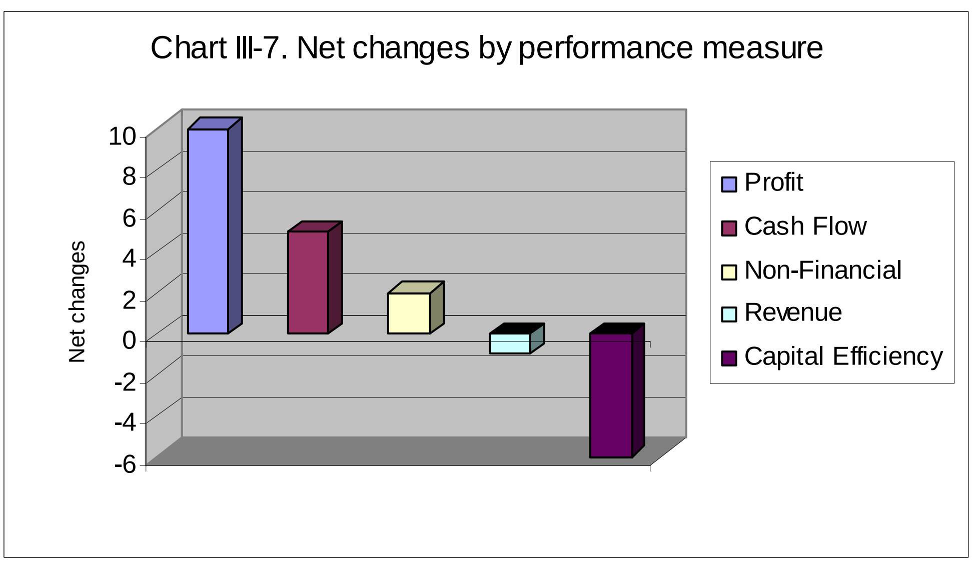
During an economic downturn, companies tend to focus more heavily on cash flow. Hence, seven companies (representing 23 percent of the reported increases) increased the weight on this type of measure. For example, Office Depot Inc (NYSE: ODP) added Cash Flow as one of their STI measures for 2009.

In addition, profitability has also been emphasized by companies since the earnings per share ("EPS") weight has been increased by six companies (19 percent of the reported increases) and Operating Income weight has been increased by three companies (10 percent of the reported increases). For example, Tesoro Corp (NYSE: TSO) increased the weights of free cash flow, operating income and EPS for 2009.



On the other hand, in these difficult times, capital efficiency as a performance measure has declined in importance. Hence, the Return on Equity ("ROE") weight has been decreased by three companies (15 percent of the reported decreases). For example, Public Service Enterprise Group (NYSE: PEG) has replaced ROE by EPS.

Ten percent of companies (20 companies) made other changes to their 2009 STI program, such as changing their performance curve or their target bonus opportunities.



Changes to the STI Pay for Performance Curve

Fifteen companies made changes to their Pay for Performance Curve. The details of these changes are as follows:

- Decrease target payout level (3 companies) and increase target payout level (2 companies),
- Decrease maximum payout level (4 companies),
- Increased the difficulty to reach target payout for 2009 (2 companies),
  - Changed the definition and the target of their measures (3 companies), and
  - Lowered the performance threshold from 50 percent to 25 percent of the target (1 company).

3 companies made other changes to their 2009 STI plans, including:

- Announcement at the beginning of the performance period that their NEOs will forego their bonus in 2009 (2 companies) and
- Announcement that a new STI Plan will be designed in 2009 for second half of 2009 (1 company).

Changes to Long-Term Incentive Plans

Changes to the LTI Plan (74 companies) include changes to LTI mix, performance measures, grants, cash plans, performance periods or goals.

The majority of reported changes impact LTI plans (39 percent). A breakdown of the changes is as follow:

- Shifts in LTI mix (17 percent),
- Change in LTI performance measures (9 percent)—see Chart III-7,
- Reduction of LTI grants (7 percent) with a median decrease of 15% in value. The reductions typically apply to all NEOs (all but two cases),
- Cancellation of LTI cash plan (3 percent),
- Lengthening of the performance period (2 percent), and
- Introduction of intermediate goals (2 percent).

Chart III-8. Changes in LTI Performance Measures

	Changes to Weight or Emphasis		
Performance Criteria Type	**No of Reported increases**	**No of Reported Decreases**	**Net Changes**
Capital Efficiency: Return on equity, relative return on equity, return on invested capital, economic value added	5	0	5
Cash Flow: Free cash flow, operating cash flow	2	0	2
Total Shareholder Return: Stock price appreciation plus dividends (relative and absolute)	6	4	2
Profit: EPS, relative EPS growth, net income, corporate income, operating income, operating profit, OIBDA	5	5	0
Other: relative measure based on total direct premiums written, absolute measure based on vested net premiums earned	1	1	0
TOTAL	19	10	9

Chart III-9. Weight Changes by Performance Measures

Specific Performance Measures	Increased	Decreased
Total Shareholder Return (“TSR”)	6	4
Return On Invested Capital	2	0
Earnings Per Share Growth (relative measure)	1	0
Average Return On Equity	1	0
Return On Equity (relative measure)	1	0
Economic Value Added	1	0
Operating Profit	1	0
Net Income	1	0
Corporate Income	1	0
Operating Cash Flow	1	0
Free Cash Flow	1	0
Total Direct Premiums Written (relative measure)	1	0
Earnings Per Share	1	4
Operating Income Before Depreciation and Amortization	0	1
Vested Net Premiums Earned (absolute measure)	0	1
Total Number of Measures Changed	19	10

Total Shareholder Return weight continues to increase in LTI plans. It has been added by six companies and represents 32 percent of the reported increases. Overall, the emphasis in LTI programs appears to be on capital efficiency, cash flow and TSR.

Change in LTI Mix

17 percent of companies have changed their LTI mix with the pronounced effect resulting in a move from stock options to restricted shares and units.

Chart III-10 Changes in LTI mix

Type of Plan	No of Reported Increases	No of Reported Decreases	Net Changes
Restricted Shares and Units	13	9	4
Performance Shares and Units	13	14	-1
Stock Options and SARs	6	16	-10
Total	32	39	-7

Other Items of Interest

Approximately one quarter of the companies have reported changes in 2009 on an exclusive basis.

For example:

- Changes to their base salary only (14 percent),
- Changes to their LTI program only (7 percent), and
- Changes to their STI program only (3 percent).

Changes to Severance, Perquisites and Retirement Plans

28 companies (15 percent) have announced some changes to their severance, retirement and/or perquisite programs.

- Reduced their severance package (e.g., reduced their severance multiple, CIC payments or eliminated their tax gross-up) (4 percent),
- Eliminated perquisites or cancelled their tax gross-ups associated with payment of perquisites that result in imputed income (9 percent),
- Modified their retirement plans (e.g., suspension of contributions to the 401(k), frozen or eliminated SERP benefits) (3 percent), and
- Introduced clawback policies that will cancel or recoup incentive awards if executive officers engage in bad behavior of various types (3 percent).

Summary

Our findings show:

(i) Greater focus on short-term cash flow results which is counter to the direction suggested by the U.S. Treasury, academics and other expert advisers regarding ways to mitigate risk, which is to encourage a long-term perspective by subjecting more compensation to stock price risk; and
(ii) More reliance on restricted stock and restricted stock units which is not performance-based as it vests simply with the passage of time.

We suggest that companies consider:

(a) Rebalancing their short- and long-term incentive target opportunity levels which may result in (x) a reduction of STI levels, or (y) a combination of reduction of STI levels and a slight increase in LTI levels;
(b) Change the LTI mix away from restricted stock (or units) to a more performance-based award program; and
(c) Revise the pay for performance curves for both short- and long-term incentive plans by reducing maximum payout levels.

These changes collectively will better align corporate risk, corporate performance and executive pay.

Companies strive to balance risk vs. reward vs. corporate performance. Recent proposed legislation and SEC rules changes will require companies to discuss corporate risk with regard to executive compensation. Each company needs to determine the executive compensation program that is right for them taking into account the various types of risk.

There are various types of risk that need to be addressed. Here are a few of the risks:

- Setting the wrong goals which may substantially impair the company and not create value;
- Paying too much compensation that is not closely connected to performance (e.g., restricted stock, guaranteed or retention bonuses, large severance payouts with our without a change-in-control, large pension entitlements, generous perquisites);
- Paying too much of the pay in incentive compensation combined with a small salary that may encourage risky behavior with either corporate strategy or financial accounting;
- Creating windfall compensation (e.g., large severance payout or extremely large bonus);
- Overpaying executives in a systematic way over a period of time which depletes the financial vitality of the company; and
- Paying cash bonuses for short-term performance that turns out to be specious and ultimately causes stock price to drop over time.

There are many examples that are associated with each of these types of risks.

Suggestions for ways to reduce risk and align pay with performance:

- *Increased emphasis on long-term pay:* Unlike short-term incentives, long- term pay keeps management focused on the long-term value creation and protects shareholders from paying compensation based on short-term results, and at times, specious results. Subject more compensation to stock price risk: Partial (40% or more) deferral of bonus into company stock: This protects companies from paying enormous payouts for short-term spikes. Other ideas to consider to subject pay to stock price risk:
  - *Stock ownership requirements:* Requiring significant ownership in the company is a way in which management provides additional "skin in the game" and subjects wealth accumulation to stock price risk.
  - *Hold equity until retirement:* While similar to stock ownership guidelines, this prevents management from "unloading" equity during high periods of growth and reducing their link to shareholders.

- *Pay Clawbacks:* Protects against the generation of "bad business" that first appears to be profitable but is reversed when the economy or other factors change and ultimately is unprofitable.

- *Impose caps on bonus payouts and reduce maximum payouts:* When companies have unexpected and transitory growth, bonus payment should be capped. What we have learned during this financial meltdown is that companies which had enormous growth were unable to sustain that level of growth and were substantially affected by downturn.

- *Careful use of perquisites:* Although perquisites represent a relatively small portion of pay, they never-the-less have become a focal point of shareholders, shareholder activist groups, and media ire. No gross-ups on pay or benefits of any type.

List of the 200 Companies in the Study Group (Alphabetical Order)

3M CO	COMCAST CORP
ABBOTT LABORATORIES	COMPUTER SCIENCES CORP
AES CORP	CONAGRA FOODS INC
AETNA INC	CONOCOPHILLIPS
AFLAC INC	CONSOLIDATED EDISON INC
ALCOA INC	CONSTELLATION ENERGY GRP INC
ALLSTATE CORP	COSTCO WHOLESALE CORP
ALTRIA GROUP INC	COVENTRY HEALTH CARE INC
AMAZON.COM INC	CSX CORP
AMERICAN ELECTRIC POWER CO	CUMMINS INC
AMERICAN EXPRESS CO	CVS CAREMARK CORP
AMERISOURCEBERGEN CORP*	DANAHER CORP
AMGEN INC	DEAN FOODS CO
ANADARKO PETROLEUM CORP	DEERE & CO
APACHE CORP	DELL INC
APPLE INC*	DEVON ENERGY CORP
ARCHER-DANIELS-MIDLAND CO	DIRECTV GROUP INC
AT&T INC	DISNEY (WALT) CO*
AUTONATION INC	DOMINION RESOURCES INC
BAKER HUGHES INC	DONNELLEY (R R) & SONS CO
BANK OF AMERICA CORP	DOW CHEMICAL
BANK OF NEW YORK MELLON CORP	DU PONT (E I) DE NEMOURS
BAXTER INTERNATIONAL INC	DUKE ENERGY CORP
BEST BUY CO INC	EATON CORP
BOEING CO	EDISON INTERNATIONAL
BRISTOL-MYERS SQUIBB CO	EMC CORP/MA
BURLINGTON NORTHERN SANTA FE	EMERSON ELECTRIC CO*
CAPITAL ONE FINANCIAL CORP	ENTERGY CORP
CARDINAL HEALTH INC	EXELON CORP
CARNIVAL CORP/PLC (USA)	EXPRESS SCRIPTS INC
CATERPILLAR INC	EXXON MOBIL
CBS CORP	FEDEX CORP
CENTERPOINT ENERGY INC	FIRSTENERGY CORP
CHESAPEAKE ENERGY CORP	FLUOR CORP
CHEVRON CORP	FORD MOTOR CO
CHUBB CORP	FPL GROUP INC
CIGNA CORP	FREEPORT-MCMORAN COP&GOLD
CISCO SYSTEMS INC	GAP INC
CITIGROUP INC	GENERAL DYNAMICS CORP
COCA-COLA CO	GENERAL ELECTRIC CO
COCA-COLA ENTERPRISES INC	GENERAL MILLS INC
COLGATE-PALMOLIVE CO	GENERAL MOTORS

* The 9 companies have not filed yet when we reported the changes or have merged in the case of Merck and Wyeth.

GILEAD SCIENCES INC	MORGAN STANLEY	TEXAS INSTRUMENTS INC
GOLDMAN SACHS GROUP INC	MOTOROLA INC	TEXTRON INC
GOODYEAR TIRE & RUBBER CO	MURPHY OIL CORP	TIME WARNER CABLE INC
GOOGLE INC	NATIONAL OILWELL VARCO INC	TIME WARNER INC
HALLIBURTON CO	NEWS CORP	TJX COMPANIES INC
HESS CORP	NIKE INC -CL B	TRAVELERS COS INC
HEWLETT-PACKARD CO*	NORTHROP GRUMMAN CORP	TYCO ELECTRONICS LTD
HOME DEPOT INC	NUCOR CORP	TYSON FOODS INC -CL A
HONEYWELL INTERNATIONAL INC	OCCIDENTAL PETROLEUM CORP	U S BANCORP
HUMANA INC	OFFICE DEPOT INC	UNION PACIFIC CORP
ILLINOIS TOOL WORKS	OMNICOM GROUP	UNITED PARCEL SERVICE INC
INGERSOLL-RAND CO LTD	ORACLE CORP	UNITED STATES STEEL CORP
INTEGRYS ENERGY GROUP INC	PACCAR INC	UNITED TECHNOLOGIES CORP
INTEL CORP	PARKER-HANNIFIN CORP	UNITEDHEALTH GROUP INC
INTL BUSINESS MACHINES CORP	PENNEY (J C) CO	VALERO ENERGY CORP
INTL PAPER CO	PEPSI BOTTLING GROUP INC	VERIZON COMMUNICATIONS INC
ITT CORP	PEPSICO INC	VIACOM INC
JABIL CIRCUIT INC	PFIZER INC	WALGREEN CO
JACOBS ENGINEERING GROUP INC*	PG&E CORP	WAL-MART STORES INC
JOHNSON & JOHNSON	PHILIP MORRIS INTERNATIONAL	WASTE MANAGEMENT INC
JOHNSON CONTROLS INC*	PPG INDUSTRIES INC	WELLPOINT INC
JPMORGAN CHASE & CO	PROCTER & GAMBLE CO	WELLS FARGO & CO
KELLOGG CO	PROGRESSIVE CORP-OHIO	WHIRLPOOL CORP
KIMBERLY-CLARK CORP	PRUDENTIAL FINANCIAL INC	WILLIAMS COS INC
KOHL'S CORP	PUBLIC SERVICE ENTRP GRP INC	WYETH*
KRAFT FOODS INC	QUALCOMM INC	XCEL ENERGY INC
KROGER CO	QWEST COMMUNICATION INTL INC	XEROX CORP
L-3 COMMUNICATIONS HLDGS INC	RAYTHEON CO	YUM BRANDS INC
LILLY (ELI) & CO	SAFEWAY INC	
LOCKHEED MARTIN CORP	SARA LEE CORP	
LOEWS CORP	SCHERING-PLOUGH	
LOWE'S COMPANIES INC	SCHLUMBERGER LTD	
MACY'S INC	SEARS HOLDINGS CORP	
MARATHON OIL CORP	SOUTHERN CO	
MARRIOTT INTL INC	SPRINT NEXTEL CORP	
MARSH & MCLENNAN COS	STAPLES INC	
MCDONALD'S CORP	STATE STREET CORP	
MCKESSON CORP	SUN MICROSYSTEMS INC	
MEDCO HEALTH SOLUTIONS INC	SUNOCO INC	
MEDTRONIC INC	SUNTRUST BANKS INC	
MERCK & CO*	SUPERVALU INC	
METLIFE INC	SYSCO CORP	
MICROSOFT CORP	TARGET CORP	
MONSANTO CO	TESORO CORP	

* The 9 companies have not filed yet when we reported the changes or have merged in the case of Merck and Wyeth.

About James F. Reda & Associates LLC

James F. Reda & Associates is a nationally recognized independent compensation and corporate governance consulting firm. Located in New York, New York (headquarters) with a satellite office in Atlanta, Georgia, our principal consultants have over 50 years of combined experience in compensation consulting. Our consultants are quoted frequently in leading media publications such as BusinessWeek, Forbes, Fortune, The New York Times, and The Wall Street Journal.

Our firm has extensive experience in the areas of equity awards, compensation committee advisory services, incentive programs of all kinds, and the performance evaluation and goal-setting process. We work with clients from the following industries: financial services, health-care, life-science, technology, retail and manufacturing. We have substantial experience working with private companies.

James Reda has authored two books on the subject of executive compensation and the role of the compensation committee, entitled *Pay to Win: How America's Successful Companies Pay Their Executives* (Harcourt: 2000), and *The Compensation Committee Handbook* (John Wiley: 2007), which is in its third edition. Mr. Reda served as a commissioner on the national panel "Executive Compensation and the Role of the Compensation Committee," assembled by the National Association of Corporate Directors. Mr. Reda is also a member of a task force created by pre-eminent trade group the National Association of Stock Plan Professionals in order to rationalize executive compensation.

Our Services Include:

- Advising compensation committees on all executive compensation matters
- Providing corporate governance advice with respect to executive and board compensation
- Benchmarking total compensation, including: base salary, short-term incentives, long-term incentives, executive benefits and perquisites
- Assisting with all aspects of short- and long-term incentive plan design, including: tax, accounting, and SEC implications of such arrangements
- Working with companies to determine competitive employment agreement plan designs
- Providing expert witness testimony, opinion, and litigation support
- Evaluating CEO, other senior executives and board
- Providing assumption analysis and expense calculation for FAS 123R purposes
- Designing executive ownership guidelines and capital accumulation programs
- Reviewing special situation incentives associated with IPOs, business units, partnerships, distressed companies, and mergers & acquisitions
- Designing deferred compensation, supplemental executive retirement programs (SERPs) and other executive perquisite and benefit programs
- Designing change-in-control and severance programs