Director Compensation

Compensating Directors for Unusual or Extraordinary Service

Setting pay practices for situations where the call of duty demands long hours is more art than science.

By Dayna Harris

By virtue of their oversight role, directors of publicly traded companies have significant exposure to individual liability. And while directorship requires a significant time commitment—a fact that is reflected by how companies implement competitive director compensation programs—it's a role that does not constitute a full-time position. Does remuneration need to be rethought when circumstances require extraordinary service commitments? To answer this question, boards need to define what constitutes extraordinary service, establish a process to determine reasonable special compensation for such service, and disclose in the annual proxy statement how extraordinary service is compensated.

Unusual or Extraordinary Service

Determining what constitutes extraordinary service is a subjective exercise. A key indicator of an event outside the normal scope of duty may include a material issue or problem that needs to be addressed that is outside the normal annual operating environment. Examples include accounting or financial irregularities, environmental disasters, a government agency investigation, a merger or acquisition, litigation, or issues pertaining to CEO succession. These are often one-time or infrequently occurring circumstances that require substantial time to resolve. While the entire board may be required to make final decisions, the bulk of the work is usually carried out by a few directors, often through a special committee set up for the specific task.

In a recent Farient Advisors review of S&P 500 companies' proxy statements covering fiscal years 2010 to 2015, approximately 70 companies disclosed special compensation arrangements for directors. In addition, more than 90 percent of these companies provided the increased compensation as a special cash retainer, either a one-time amount for the year, a monthly retainer, or the occasional daily fee. The remaining companies provided an additional equity grant. Approximately 20 percent of the companies that disclosed special pay arrangements used an established policy under which the directors would be paid if a special committee were to be convened or if directors took on a special project.

Determining Special Compensation

Determining the final overall amount of any additional pay in advance may not be realistic since the time needed to resolve major issues is largely unknowable. In practice, many companies make the determination later in the fiscal year or after the issue is resolved, evaluating the actual additional time commitment invested and by whom. In other cases, it may quickly become apparent that the issue is extraordinary and will require substantial time commitment, in which case a monthly "stipend" may be authorized. For those companies that have instigated special compensation policies in advance as part of their disclosed board pay programs, many still reserve the right to use discretion for additional pay if they deem it appropriate in the context of the circumstances.

Also, arriving at the actual amount is more art than science. Because there is a wide range of time commitments undertaken by each company for a particular issue—and those time commitments are not disclosed—it's difficult to try to benchmark one company's pay practices against those of other companies. A better approach is to develop a general sense of how much additional time is (or was) required for a given issue and paying for that time at an appropriate pay level for similar service under normal circumstances at the company. This could involve comparing the number of meetings that a special committee had with the normal meetings at standing committees of the company, and then providing an annual retainer to members of the special committee that is commensurate with time commitments of other standing committees. Alternatively, if the additional work is performed by a standing committee, an additional special retainer could be provided to members commensurate with the number of meetings in excess of normal meetings for this particular standing committee. For extraordinary issues where the level of commitment requires the equivalent of full-time employment, a monthly stipend that reflects the greater time commitment would be in order.

The following examples illustrate how some companies have handled additional director pay:

- Tyson Foods, a producer of chicken, beef, pork, and branded, prepared foods, disclosed in its 2015 proxy statement the pay for members of the strategic and acquisition committee. This special ad hoc committee was tasked with integration and strategic activities subsequent to the acquisition of The Hillshire Brands Co. in 2014. Each committee member received $25,000 for all of fiscal year 2015.
- Public Storage, a real estate investment trust specializing in the acquisition, development, ownership, and operation of self-storage facilities, disclosed in its 2012 proxy statement the pay for members of its special committee that was formed to purchase all of the outstanding limited partnership units of certain limited partnerships. Each member of the special committee received $25,000 in 2012, and the chair received a total of $50,000.
- Lumber Liquidators Holdings recently faced unfavorable allegations that Lumber Liquidators was selling laminated hardwood flooring that did not meet U.S. air quality standards. Numerous civil suits were filed related to product quality. In addition, several senior executives left the company. Ultimately, Lumber Liquidators entered a plea agreement with the U.S. Department of Justice in October 2015. This situation was not specifically mentioned in the company's 2015 proxy statement; however, the company disclosed the formation of two non-standing committees to address legal and regulatory matters: a special committee formed in March 2015 and a demand review committee formed in June 2015. Each member of these committees was to be paid $1,000 per day or per meeting, and the chair $1,500 per day or meeting. By May 2015, pay for the chair of the special committee was set as a flat fee of $35,000 per month. By November 2015, the pay for the chair of the demand review committee was changed to $20,000 per month. In addition, any board members who assisted the special committee who were not already a member received $1,000 per day as compensation.

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- Barnes & Noble has experienced dramatic industry changes over the past decade, namely the rise of Internet book sales and disruptive technologies such as Amazon's Kindle and Apple's iPad. A key competitor, Borders Group, filed for bankruptcy in 2011, leaving Barnes & Noble as the last remaining national bookstore chain in the U.S. Even so, Barnes & Noble experienced operating losses in 2011, 2012, and 2013. While these conditions were not specifically addressed in the 2012 and 2013 proxy statements, Barnes & Noble disclosed the formation of a strategic committee with the purpose of exploring strategic alternatives. From July 2012 through August 2013, each member of the strategic committee received $20,000 per month, and the chair received $25,000 per month.

Proxy Disclosure of Additional Pay

These examples illustrate that most disclosures on special director compensation have been limited to who provided additional work for a special or ad hoc committee and how much that person was compensated. While more detailed disclosures are not currently required, it could be beneficial to provide more descriptive information to shareholders, especially considering how director pay is under increasing investor scrutiny. This would be particularly important if the additional pay is significantly higher than regular director pay.

Adopting a policy in advance of any potential need for additional director pay creates greater transparency around the process for deciding "special circumstance" pay. In addition to establishing guidelines for the board regarding what to do if the company faces a difficult and unusually time-consuming issue, this policy could also set expectations for shareholders that there are occasions when a company may need to reward board members for work outside the scope of their normal responsibilities. While this type of policy would effectively handle many of the unusual situations that require a greater time commitment, it may not fully address the circumstances that are extraordinary. As result, the policy would need to be clear that the company could still adjust the amount of extra pay where extraordinary circumstances so warranted.

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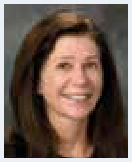

and board compensation. She focuses on designing incentive programs that align compensation with business strategy and value creation for shareholders.