

COMPLIANCE WEEK

Coke Director Pay Plan Raises Eyebrows

By Stephen Taub — April 18, 2006

When Coca-Cola recently announced plans to tie all its compensation for its board of directors to specific performance targets, Chief Executive Officer Neville Isdell crowed: “This all-or-nothing approach to board compensation aligns the interests of our directors with those of shareowners more closely than any other compensation formula I have seen.”

Other hurrahs from elsewhere in the company followed. James Robinson, chairman of Coke’s committee on directors and corporate governance, said shareholders “understand that they are only rewarded when the company performs ... The Board will hold itself to the same standard.” Even Coke’s largest shareholder, famed investor Warren Buffett, endorsed the policy.

Most compensation and governance experts, however, say tying director compensation to performance is a bad idea.

“It leaves a conflict of interest between management and directors,” says Pearl Meyer, an executive compensation consultant at Steven Hall & Partners. “If compensation is based on goals they are setting, you can ultimately say they are not disinterested. They can set the goals low.”

The plan, which takes effect this year, grants directors equity share units each year equal to a flat fee of \$175,000, and sets a three-year performance period with a target of 8 percent compound growth in earnings per share. If the performance goal is met at the end of the three years, the share units will be payable in cash; if missed, directors forfeit the whole package.

Coke’s 8 percent growth target is the mid-point of its long-term performance goal. Critics, however, contend that using earnings per share as a benchmark to set performance pay is probably the worst measure, since the figure can easily be manipulated. And while the performance target spans a three-year period, compensation specialists say it could pull the directors’ focus away from longer-term goals.



“Directors are there partly to be advisers to management, and not act like management,” says David Swinford, senior managing director for Pearl Meyer and Partners (a compensation firm founded by Meyer, who has since decamped to Hall & Partners).

Swinford also worries that by paying directors for performance, the corporate system of checks and balances could deteriorate; directors, he says, should be paid for their time rather than the overall success of the plan they endorse or criticize. “It’s hard to be objective if you are continuously rewarded for blessing the recommendations of the management teams,” he says. “Directors are then put in the same shoes as management.”

RELATED RESOURCES

-  [Coca-Cola's 8-K Filing On Compensation Plan \(April 5, 2006\)](#)
-  [Coke's Press Statement On Compensation Plan \(April 5, 2006\)](#)
-  [Meyer & Partners Report On Director Compensation](#)
-  [ISS Report On Director Compensation](#)

Related Coverage

-  [Additional Studies Confirm CEO, Director Pay Up \(Nov. 15, 2005\)](#)
-  [In Rare Move, Continental Cuts Director Fees 30 Percent \(Feb. 22, 2005\)](#)

EXCERPT

Below are excerpts from some of the components of Coca-Cola's new director compensation plan, as explicated in the company's "Compensation Plan For Non-Employee Directors Of The Coca-Cola Company," as attached to a Form 8-K filed April 5. The complete filing is available below:

- **Limitation to Non-Employee Directors.** Only Directors who are not employed by the Company or a Majority-Owned Related Company shall be eligible for the Plan.
- **Accounts and Sub-Accounts.** Each Participant shall have an Account administered in his or her name. Such Account shall be a bookkeeping entry only and no Stock or other assets shall be placed in the Participant's name. There shall be separate sub-Accounts for each Performance Period.
- **Crediting of Share Units.** On the Grant Date, each Participant's Account shall be credited with Share Units. The dollar amount for the period beginning January 1, 2006, shall be \$175,000 and may be adjusted in subsequent years by the Board of Directors. The number of Share Units credited to each Participant shall be determined by dividing this dollar amount by the average of the high and low price of Stock on the Grant Date.
- **Setting of Performance Target.** On the Grant Date, the Board of Directors shall set the Performance Period and the Performance Target applicable for that Performance Period. The Performance Target may not thereafter be changed.
- **Hypothetical Dividends.** As of each date on which dividends on the Stock are payable to shareowners, each Participant's Account shall be credited with the value of the dividends that would be payable on Share Units if they were shares of Stock. These hypothetical dividends shall be converted to additional Share Units using the average of the high and low price of Stock on the dividend payment date or if such date is not a trading day, the next trading day.
- **Payment only if Performance is Achieved.** No amounts shall be payable under this Plan unless the applicable Performance Target is achieved during the applicable Performance Period. The performance shall be certified by the Audit Committee of the Board of Directors at the regularly-scheduled February meeting of the Audit Committee following the end of the Performance Period.

In general, he stresses that directors should be objective, act as a sounding board for management, be a check for overly aggressive or overly conservative management, and operate above the fray.

Another crucial element of Coke's plan calls for the elimination of all additional fees for such duties as chairing board committees and attending board and committee meetings. "This was a trend a few years ago," Swinford says. "It gets away from an administrative need to track meetings or paying more for more meetings."

Swinford and others don't necessarily believe eliminating additional fees is a good idea. Scott Fenn, managing director for policy at Proxy



Fenn

Governance, says it "goes against the grain of the trend to segment director pay based on the roles they play." Fenn says directors should be rewarded more for chairing a committee or sitting on a tougher committee, such as the compensation or audit committee. Additional fees, he says, help recruit people with the needed skill sets.

Swinford notes that much board work is performed at the committee level, sometimes as much as half the total job of being a director. "You want to reward them for the extra time they are sitting on a committee," he says. Canceling additional fees "is strange. It takes away incentives to attend meetings and sit on tough committees."


A Backdrop Of Higher Fees

Coke's move comes amid a turbulent time for director compensation. Meyer & Partners conducted a study of proxy reports filed by 200 large corporations last year, and found average overall director compensation surged by double digits for the second consecutive year to more than \$195,000 (see box above for related studies and coverage).

Retainers, on average, jumped 19 percent to \$16,100 for audit committee chairmen and by 14 percent to \$11,300 for compensation chairmen. But average compensation for committee service

- **Payment of Account Balance.** If the Performance Target has been achieved during the Performance Period, the Participant shall be paid his or her Account balance attributable to that Performance Period on February 28 following the certification of results, unless the Participant elected to defer the compensation as provided in Section 4.7 below. The value of the Share Units attributable to the Performance Period shall be determined by using the average of the high and low price of Stock on the date the performance is certified. If the Performance Target is not achieved, the entire Account balance attributable to the Performance Period shall be forfeited as of the date the performance is certified.
- **Form of Payment.** All payments under this Plan shall be in cash.
- **Resignation of Director.** If a Director resigns from the Board during the Performance Period, the Share Units attributable to each Performance Period shall be prorated. The proration shall be a fraction, the numerator of which is the number of days from the beginning of the applicable Performance Period to the date of the Director's resignation and the denominator of which is the number of days in the Performance Period. No payment shall be made unless the Performance Target is achieved and payment, if any, shall be made at the same time and valued in the same manner as the Share Units for the other Participants. Hypothetical dividends on the prorated Share Units are credited for the remainder of the Performance Period.

Source

 [Compensation Plan For Non-Employee Directors Of The Coca-Cola Company \(8-K Filing, April 5, 2006\)](#)

actually declined slightly, mostly due to companies eliminating committee meeting fees.

A similar study by Institutional Shareholder Services echoed those findings. It said average pay for U.S. corporate directors climbed 14 percent in 2005 to \$143,800. Chairmen of the audit, compensation and nominating committees, respectively, received extra pay 80 percent, 73 percent and 59 percent of the time. That pay typically took the form of additional retainers; audit committee chairs received roughly \$10,000 extra, compensation and nominating committee chairs just more than \$7,000.

Compensation research firm Equilar, meanwhile, scrutinized of proxies filed for the Dec. 31, 2005 fiscal year and found that companies appear to be moving away from meeting fees. At least 15 corporations scrapped board or committee meeting fees, including such names as AMN Healthcare Services, Cytec Industries, Idex Corp., Flir Systems and Fortune Brands. In addition, committee chair premiums were eliminated at Fifth Third Bancorp and Goodrich Corp.

Equilar notes that all of these companies replaced their meeting fees by introducing or increasing corresponding annual retainers. Idex, for example, introduced a \$10,000 annual "attendance fee;" First Indiana introduced a cash portion to its annual retainer and specified that "payment for the fourth quarter is contingent upon attendance of at least 75 percent of all board and committee meetings applicable to that director."

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