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EXCLUSIVE REPORTS
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Directors get fatter checks

Board pay rises with workload

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At many of Puget Sound's largest public companies, independent board members are getting a raise.

For instance, F5 Networks Inc. of Seattle has begun paying a $35,000 annual retainer to all the members of its audit committee. Kirkland-based Nextel Partners Inc., after years of offering no cash compensation, instituted a $10,000 retainer for all the company's board members. And Coinstar Inc. of Bellevue added a $25,000 annual fee for the board chair.

In board rooms around Seattle, paychecks are getting fatter to attract and retain qualified board members from outside the company. Corporations say pay needs to go up because of the increased workload generated by the Sarbanes-Oxley Act and other regulatory reforms. They also cite the need to offer pay that's competitive, and enticing enough to overcome directors' fears of liability.

The form of that compensation is also changing, with stock options falling out of vogue in favor of slower-vesting forms of equity.

In the past, board members at a company have often all received the same pay package. But the rising workload in a few key positions -- most notably board chair or lead director, and audit committee chair -- has created a new paradigm where directors' pay reflects their responsibilities, said Ralph Ward, author of the book "Saving the Corporate Board," published this month.

"There's going to be more differentiation within the board on director pay," he said. "The chair of audit is getting paid considerably more due to the large amount of effort they'll have to put in now."

An indicator of the rising workload: an annual survey of more than 2,000 board members conducted by Korn/Ferry and Corporate Board Member magazine showed directors spent an average of 183 hours annually at their duties last year, compared with 156 hours in 2001.

Coinstar spokeswoman Marci Kenny said her company looked at four different compensation studies before adjusting its pay package. Board members' annual retainer doubled from $10,000 to $20,000 per year, and board chair Keith Grinstein, an outside director, receives an additional $25,000 retainer.

"We discovered we were not compensating based on what the market is paying," she said. "So it came down to being competitive so we can retain and attract quality board members."

Another company that added pay for a key job is Potlatch Corp. of Spokane. As of Jan. 1, the board's vice chair receives a $15,000 additional retainer, or $39,000 in total cash compensation.

Additional pay for such jobs has become the norm. A study of 400 companies in the Russell 3000 index, conducted in September by corporate governance consultants Equilar Inc., showed that 85 percent of audit committee chairs and 76 percent of audit committee members were receiving additional fees for serving in those posts.

Author Ward said that in the past, the board chair was often also the company CEO. That structure is now being criticized by some investors as providing inadequate oversight of top managers' actions.

Increasingly, board chair positions are being filled by outside directors, or if the CEO remains chair, a lead director position is being created. Pay for these directors must reflect their additional responsibilities, Ward said.

While some companies added pay for specific board jobs, others re-examined what they pay all their board members.

Nordstrom Inc. tinkered with its pay package last year, raising its value overall but cutting cash from $49,000 to $45,000. The company's stock grant was raised from $10,000 in 2001 to $45,000 last year.

Company spokeswoman Shasha Richardson said the board members' increased responsibilities, as well as a benchmarking comparison with similar-size companies, led to the overall increase in the compensation package.

"We want our board members to be invested in the company, as are our shareholders," she said of the decision to increase stock grants. "We think it makes more sense to have a more equal balance between stock and cash compensation."

Washington Mutual Inc. added $35,000 in deferred compensation to its pay package this year. WaMu spokesman Alan Gulick said the deferred pay goes into an account that offers a return based on appreciation in WaMu stock and dividends, and is received only after the person leaves the board.

Similarly, board members at Weyerhaeuser Co. don't receive their shares until they complete their board service. And at Plum Creek Timber Co. Inc., directors' stock options vest over four years.

The policy of requiring board members to accumulate and hold substantial blocks of company shares during their board terms is a growing trend, said Bill Smith, practice leader for compensation in the Seattle office of international consulting firm Watson Wyatt. The use of stock options, which are often cashable within six months or a year, is falling out of favor because options offer too much short-term return.

Holders of stock options "like to take advantage of spikes" in the share price, "so a lot of (companies) are moving to restricted stock that vests at the end of the second or third year," he said. "Where you used to see directors required to hold their shares for a year, now they say you can't sell them until after you're off the board."

Safeco Corp., Alaska Air Group Inc., and beginning this year, Puget Sound Energy, all have stock ownership targets for their board members. For instance, Puget Sound Energy now requires directors to receive 100 percent of their pay in stock until they have two years' pay accumulated in equities. The Korn/Ferry study showed that nearly half of directors report their company has a requirement that directors own company shares.

Amazon.com Inc. switched in 2002 from paying directors in stock options to paying them in restricted stock units which serve as the company's only director compensation. The restricted stock begins vesting in three years and is completely vested in five years, a longer wait than in previous years.

Spokesman Bill Curry said the form of payment -- no cash, and slow-vesting stock -- is in line with the company's focus on long-term thinking. It also guarantees that directors will receive the restricted stock's value at the time the stock vests, unlike with stock options, which can become worthless if the stock sinks below the strike price.

"Our feeling is that this compensation squarely aligns the directors' interests with other shareholders' interests in terms of creating long-term value for all shareholders," he said.

Despite investors' preference for long vesting schedules, many local companies continue to vest stock or options in a year, including ZymoGenetics Inc., AT&T Wireless Services Inc., Washington Mutual and Nautilus Group Inc.

Stock options at F5 Networks vest immediately, and under SEC rules can be cashed after six months. Company vice president and general counsel Joann Reiter said shareholders haven't complained, likely because F5's directors have all held their shares rather than cashing them.

"I think our board is still in favor of options," she said. "We have not had requests to change that. We have a good record of people hanging onto their options."

F5 is also one of the companies that has added cash retainers to its board compensation. With all three of its independent directors serving on its audit committee, F5 instituted a $35,000 annual retainer for audit committee members last year.

"The fact is, audit committees are doing a lot more work these days, so that's why we instituted that payment," she said. "I believe a lot of people probably have changed that, but you just haven't seen it reported yet."

With the trend toward increasing cash retainers, some local companies that never paid cash appear to be reconsidering. Besides Nextel, which paid its first $10,000 retainer last year, Cray Inc. noted in its proxy filed last month that it is reconsidering its no-cash position due to Sarbanes-Oxley and other regulatory reforms. And Starbucks Corp., in an e-mail response, said it is currently reviewing its director pay and considering several forms of compensation.

Despite all the pay hikes, Watson Wyatt's Smith believes that pay at Washington's large public companies remain conservative compared with that of similar companies nationwide. A survey of the proxies of the Fortune 1000 companies showed the average total director pay package is between $75,000 and $80,000. The average cash retainer is $42,000.

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