AGENDA

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THE WEEK'S NEWS FROM OTHER BOARDROOMS

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Why Home Depot Board Gave Investors Silent Treatment

At **Home Depot**'s annual meeting in Wilmington, Del., a man in a chicken suit held a sign chastising CEO **Bob Nardelli** for his compensation package. The chicken man was part of a small group from the labor union AFSCME protesting Nardelli's sizable pay plan in the face of falling stock value.

Bonnie Hill
Compensation Committee Chair
Home Depot

Home Depot's board of directors missed out on the antics, not because they were whisked through the back door, but because they were hundreds of miles away at a closed meeting in Atlanta. The directors skipped Home Depot's annual meeting, a move that is being criticized by shareholder activists and directors alike.

Bonnie Hill, chair of the compensation committee with Home Depot, defends the board's actions, saying the meeting was going to be usurped by a few activist shareholders whose agendas would muscle out the shareholders who actually wanted a fair and frank discussion.

"There is no good purpose served for a few to dominate a meeting for the

Silent Treatment *(continued on page 11)*

Directors Now Paid in Full-Value Shares at Eli Lilly, BellSouth

Eli Lilly, **Merrill Lynch** and **BellSouth** are three of several companies that have eliminated stock options from their board members' pay packages in the past few months. Now, the equity portions of those companies' director compensation plans are made up entirely of full-value shares.

Other Fortune 1000 firms, such as **Manpower**, **Cytec**, **Timken Co.** and **Arkansas Best**, have made similar moves. Directors and compensation analysts say the shift in director compensation reflects boards' desire to better align their pay with shareholder interests.

Unlike these maverick companies, however, most haven't switched to full-value shares entirely and are still using some stock options in their director pay mixes. But the proportion of full-value-share grants in the equity portion of director comp packages is growing.

Full-Value *(continued on page 10)*

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Heinz Digs In for Long Battle With Hedge Fund

Investor **Nelson Peltz** has put forward a plan based around a simple idea to squeeze more profits out of **H. J. Heinz**: Cut costs and encourage people to eat more ketchup. It is simple enough on the surface, but the company has rejected the plan, saying the details would cripple it. Their concerns involve the cost-cutting measures Peltz hopes to put in place.

Now analysts and Wall Street are picking sides in what is shaping up to be a proxy battle hot enough to make Pittsburgh feel like Pascagoula.

Peltz's plan and Heinz's rejection of it is just the latest development in a dispute that has been simmering since early this spring. Peltz and four of his deputies are trying to win change at Heinz by getting elected to the company's board at the annual meeting in August. The

Digs In *(continued on page 9)*

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Audit Committee's Load Makes Recruiting a Burden

Since the passage of Sarbanes-Oxley, finding qualified directors willing to serve on audit committees has become a bigger challenge for boards. The committee's rise in importance post-SOX is giving some boards headaches when trying to recruit qualified directors, recruiters and directors say.

According to **Harold McGraw III**, CEO and chairman of **The McGraw-Hill Companies**, there is an attitude in the corporate governance field that the audit committee is "more special."

"[The audit committee] is charged with so much responsibility since SOX, and has such a big charter," McGraw commented at a recent director education conference in New York.

Changes in Audit Committees	2005	2001
100% independent audit committees	85%	70%
Avg. # of committee meetings	9	5
Companies that compensate audit chairs extra	80%	N/A
Avg. extra pay for audit chairs	$10,000	N/A

Source: Institutional Shareholder Services

As the former audit chair at **Lowe's** and current audit chair at **PetSmart**, **Richard Lochridge** has been involved in the changing climate of audit committees since SOX. Although the responsibilities have increased, it does not mean more board members are attracted to serve on the audit committee, he says.

"The truth is, you never want to sit on an audit committee; it's not a fun committee," Lochridge says, somewhat tongue-in-cheek.

He says in general boards are having a more difficult time recruiting directors, especially when it comes to getting existing or new members to sit on the audit committee.

Part of the challenge appears to be finding sufficiently qualified committee members. The **Securities and Exchange Commission** says audit committees should have a financial expert as the chair, and if they don't, the board must publicly disclose why.

Kerry Moynihan, managing partner in the board services practice at recruiting firm **Christian & Timbers**, strongly recommends that boards have at least two or three board members who are "financial experts" as loosely defined by the SEC.

Having multiple financial experts allows the committee to rotate the chairman every couple of years and eases the burden of having one person shoulder the responsibility continuously. It is also easier to recruit directors with financial and accounting backgrounds if they know they are not the only "go-to person," Moynihan says.

"It can be a life sentence to be an audit chair," Moynihan says of boards that have only one financial expert. "And that is not appealing."

Further complicating matters, audit committee independence has climbed steadily over the past five years, according to **Institutional Shareholder Services**'s recent study "Board Practices/Board Pay," which surveyed the boards of S&P 1500 companies. In 2005, 85% of companies had fully independent audit committees. So the pool of candidates to choose from is limited primarily to independent directors.

Along with the added time commitment, some audit committee members — especially the chair/financial expert — are concerned about their liability. Some committee members are fearful they will be held to a higher fiduciary standard in court than the rest of the board members.

Elizabeth Noe, a partner in the securities and capital markets practice group in the Atlanta office of the law firm **Paul, Hastings, Janofsky & Walker**, says that she has counseled audit committees concerned about their liability risks.

"There is a possibility that an audit committee financial expert is expected to have a knowledge base that is of a different standard than other board members'," Noe says.

She says that although the SEC has reassured audit committee members that they will not have a greater liability than other directors, there is always the potential that states' corporate laws will interpret SOX requirements differently.

While financial experts are coveted on audit committees, some board members say the audit committee should have some directors without a strong financial background. **Jane Henney** sits on the audit committee at $16.7 billion health insurance company **Cigna** and has little experience in accounting or finance, but says she still adds value to the committee.

"It's a balance you have to strike. You clearly need to have enough people with expertise… but it's good to have a couple people on the audit committee that are not financial experts to ask questions," Henney says. ■

SEC Rule on Comp Consultants Would Hit Boards

When a group of **Verizon** shareholders e-mailed one of the company's top officials last month requesting the name of the consulting firm the board uses to determine executive compensation, they were shot down.

"We immediately got an e-mail saying, 'We don't want to give you that information and, by law, we don't have to give you that information,'" says **Robert Rehm**, a member and the volunteer chief financial officer of the **Association of BellTel Retirees**, the group that sent the e-mail.

The Verizon executive was correct in his assertion that the name of the board's compensation consultant isn't public information. But that's likely to change. If and when it does, the implications for compensation committees will be far-reaching, some experts say.

If enacted in their current form, the proposed **Securities and Exchange Commission** compensation disclosure rules would require that companies identify the consultant, state whether the consultant was retained directly by the committee or by the board, describe the scope of the consultant's assignment and identify any executives the consultant contacts in carrying out his or her duties.

Such a rule would have a significant impact on compensation committees, according to some experts.

"This kind of disclosure puts pressure on the compensation committee to take on a broader responsibility for managing the compensation-setting process," says **Jeff Gordon**, a **Columbia Law School** professor whose work in the field of executive compensation has been cited by the SEC.

That increased accountability is likely at the heart of some companies' reluctance to disclose the names of their comp consultants, says **Joseph Landy**, a director on the compensation committee of the $4.9 billion **Avaya**, a company that disclosed in a December proxy the names of the compensation consulting firms it uses.

"I think that directors are very hesitant to disclose anything relating to board governance these days because of personal, director and corporate liability," he says.

Gordon agrees. "Basically, anytime you require any committee of the board to step up and claim ownership of the process, you probably enhance litigation risk," he says, adding that he nevertheless believes "the conscientious compensation committee has little to fear."

The proposed rule's requirement calling for the disclosure of the individual who retained the comp consultant would also likely have a major impact on the compensation-setting process, Gordon says. At some companies, the retention and supervision of the comp consultant is considered to be part of management's function, he says.

"It would probably reveal that, among other things, the comp committees do not independently retain and supervise the work of these consultants," he says. "This kind of disclosure would create pressures that reduce management's ability to influence the process of compensation-setting and maybe the amount and type of the compensation that's awarded."

The proposed disclosure rules do not directly address a company's use of a compensation consultant's other services, Gordon says. The potential conflict inherent in those kinds of arrangements was the subject of an April column written by *New York Times* columnist **Gretchen Morgenson**.

"The very firm that helps Verizon's directors decide what to pay its executives has a long and lucrative relationship with the company maintained at the behest of the executives whose pay it recommends," she wrote.

Gordon says that in an April 10 letter to the SEC commenting on the proposed disclosure rules, he suggested they address that.

Directors, for their part, fear that will lead to "dueling consultants," with management's consulting firm battling it out with the comp committee's advisor.

That's one scenario **Pastora San Juan Cafferty**, a director with **Waste Management**, **Kimberly-Clark** and **Peoples Energy**, does not fear.

"Compensation committees should have independent consultants who do no other work for the corporation," she says.

Robert Profusek, a director at **Valero Energy**, does not see it that way.

"The notion that advice or reports to corporate directors from compensation consultants are somehow 'tainted' because the consultant may provide other services to the company is, in my view, misguided," he says. "The providers of this advice are professionals who, in my experience, take their assignments seriously and wouldn't stand for pressure from management. Finally, input from outside compensation consultants is just one of many factors that directors take into account in coming to judgments in this area." ■

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Boards Turn to Vice Chairs for Succession Solution

With CEO turnover spiking and succession planning taking on greater importance, a small yet growing number of companies are addressing succession planning for the position of board chairman specifically.

Some boards are padding the title of lead director and adding vice chairman or simply calling the lead independent director a vice chairman as an overall succession plan for the board, the companies say. The added title can also be a way to add clout to the role of the lead director, according to some executive recruiters.

Theodore Dysart, managing partner of global board practice at executive recruiting firm **Heidrick & Struggles**, says the practice of boards appointing vice chairs is a small but growing trend that is an offshoot of the near-ubiquitous presence of lead directors.

Kerry Moynihan
Managing Partner, Global Services Practice
Christian & Timbers

Dysart says the decision for companies to add vice chair to the title of lead director "depends on if boards believe the lead directors are really synonymous with an independent chairman." A lead director/vice chairman title adds authority to the lead director position, he says.

At **The Cooper Companies**, a medical device marketing firm, **Allan Rubenstein** has been vice chairman and lead director of the board since July 2002.

He says his title is distinguished from the other lead directors because as vice chair it is clear he would take over as chairman if the spot were vacated. He was formerly the independent chairman but stepped down when the incoming CEO became chairman of the board.

Rubenstein says his title as vice chairman is mostly symbolic, and that his real duties lie with his role as lead director in executive sessions.

Hillenbrand Industries, a casket and hospital bed manufacturer, named **Joanne Smith** as its independent vice chair a couple of years ago, according to **Patrick de Maynadier**, Hillenbrand's general counsel.

He says that the position was created as a succession plan for the position of chairman of the board, currently held by **Rolf Classon**. Classon is independent, so he leads the executive sessions of other independent board members as a lead director would.

Medical manufacturer **Varian**'s general counsel **John Kuo** says he would generally not recommend that a board name a lead director vice chairman unless it was part of an overall succession plan. In that case, it could be useful, he says.

Varian's bylaws indicate the board has the option of electing a vice chairman, but the current board has opted not to. Varian has a joint CEO/chairman position and a lead director.

Kuo says that a vice chair position on the board can connote a subordinate position to the chairman, while the lead director role was created simply to lead executive sessions of independent board members.

CA, **QuadraMed** and **Yankee Candle** are also among the companies that have provisions in their bylaws for directors to elect a vice chairman, though none currently have. The bylaws state that if the board decides to elect a vice chairman, that person will perform the duties of the chairman when he or she is unable to do so, though the bylaws do not detail the functions of vice chair in relation to a lead director.

At the Delaware-based bank **WSFS Financial**, **Charles Cheleden** serves on the board as vice chair and lead director. Cheleden served as interim CEO and chairman of the board in the early 1990s and stepped down to the position of vice chair when a new CEO was selected, fellow independent board member **Thomas Preston** says. After the passage of Sarbanes-Oxley, lead director was added to Cheleden's title and he now leads executive sessions of the independent directors. But Cheleden is also "genuinely viewed as a stand-in for chairman… if disaster strikes," Preston says.

When boards choose to give an independent director the title of vice chairman it's an attempt to go halfway between having an independent chairman or a lead director, according to **Kerry Moynihan**, managing partner in the board services practice at **Christian & Timbers**. He says most U.S.-based companies are not willing to separate the chairman and CEO positions, while some shareholders are still pressing the issue. The answer some companies have come up with is adding vice chair to the title of lead director to assuage shareholder concerns about director independence — but it is also a safety net if and when the chairman's seat is suddenly vacated. ■

Will Options Probe Usher In New Round of Scandals?

Just as the nation looks to turn the page on the scandals of the late 1990s, a new source of controversy is emerging from the boardrooms and executive suites of corporate America. The SEC is now investigating stock options granting processes at about two dozen companies, and prosecutors are filing charges against several others.

And that might be just the tip of the iceberg. **University of Iowa** professor **Erik Lie** estimates that up to 10% of all U.S. corporate stock options may have been backdated, according to the *Financial Times*. If that is the case, the number of companies involved could skyrocket. Lie's research has been one of the driving forces behind the SEC and federal investigations.

The *Financial Times* argues that this scandal could lead investors to again question their confidence in the U.S. markets. That questioning would be misplaced, however, writes the *San Francisco Chronicle*. While the nearly incessant disclosure of new companies under investigation is likely to draw calls for new controls, the *Chronicle* points out that Sarbanes-Oxley already takes care of the backdating problem. Still, as the Associated Press observes, backdating is only the half of it.

In most of the cases of stock options backdating currently under investigation, the alleged offenses happened before 2002. After that date, the rules enacted as part of SOX forced all executives to disclose insider trades within two days. Before SOX, disclosure was required within the first 10 days after the month in which the stock purchases were made. In a long month, that would give executives a window of up to 40 days following a purchase to make the report. During that time, an option date could conceivably be changed without anyone taking notice, allowing an executive to benefit from a lower grant price, the *Chronicle* reports.

Still, the AP points out that options gaming is not limited to backdating. Arguing that morality cannot be legislated, the AP suggests that any company can time the release of good or bad news so as to coincide with a stock grant date.

One such example is tennis shoe maker **K-Swiss**. Regulatory filings show that the company's stock options grant dates in 2003 and 2004 came at "opportune moments," writes the AP. In 2004, CEO **Steven Nichols** and CFO **George Powlick** collected their options grants in August and September, only to see shares jump 50% in the ensuing three months. They each made around half a million dollars extra in the process.

The AP suggests K-Swiss may not have been on the up and up with these deals. In May of that year, the company released news that its results would come in below expectations. That caused the stock price to depreciate in time for Nichols's and Powlick's options grants. In October, K-Swiss beat third-quarter expectations and Nichols announced it would be the company's best year ever, sparking the stock-price run-up.

Two of the newest companies caught in the fray are computer security company **McAfee** and communications transmitter **American Tower**, writes CFO.com. McAfee announced that it has fired general counsel **Kent Roberts** because of a situation involving "improper" stock option grants in 2000. The company has also retained independent counsel to help with its internal review and discussed the matter with officials from the **Securities and Exchange Commission** and the Justice Department.

American Tower just announced that the company and some of its current and past executives and directors have been named in a securities class action suit just filed in federal court. The suit alleges that the defendants breached their fiduciary duties to shareholders in how they dealt with stock options grants, according to CFO.com. The company also faces a derivative lawsuit in Massachusetts over its stock options grants and has been subpoenaed by a federal prosecutor in New York, writes the AP.

As the investigations grow wider, more questions are raised over whether it is even illegal for companies to manipulate their options dating. Regardless, the companies accused have much to lose. The **Nasdaq** has announced that it may delist companies that are being investigated, according to Bloomberg. The exchange has already sent delisting notices to **Vitesse Semiconductor** and **Altera**, each of which is delinquent in filing its financials because of backdating-related restatements. Two other companies, **Mercury Interactive** and **Nyfix**, have already been dropped under similar circumstances.

Delisting would mean even more hardship for those companies. "If a company is delisted, it will significantly impact its institutional ownership," **Brandon Rees** of the **AFL-CIO** told Bloomberg. "Most pension fund mandates to their investment managers would prohibit an investment in an unlisted company." The AFL-CIO directs $400 billion in pension funds, giving the union significant shareholder clout. ■

Of Cox and Congress: Executive Comp Gets New Look

Amid criticism from Tinsel Town, **Securities and Exchange Commission** chairman **Christopher Cox** may be backing down from the most controversial element of his compensation disclosure proposal. This comes as Congress takes a look at executive pay and ruminates over whether to take a stronger stance on the issue.

Cox told the *Los Angeles Times* that he is listening to the flood of criticism that has come in over an aspect of his plan that calls for disclosing the pay of the top three non-executives at a company if they make as much as or more than any of the company's top five officers. Among those likely affected: **Jay Leno**, **Katie Couric** and **Steven Spielberg**.

"My forecast is either the proposal will be significantly scaled back or it will be removed altogether," Cox told the *L.A. Times*. That sentiment is echoed by fellow SEC commissioner **Annette Nazareth**, who told the *L.A. Times* she's not sure the salaries of non-executive employees are relevant.

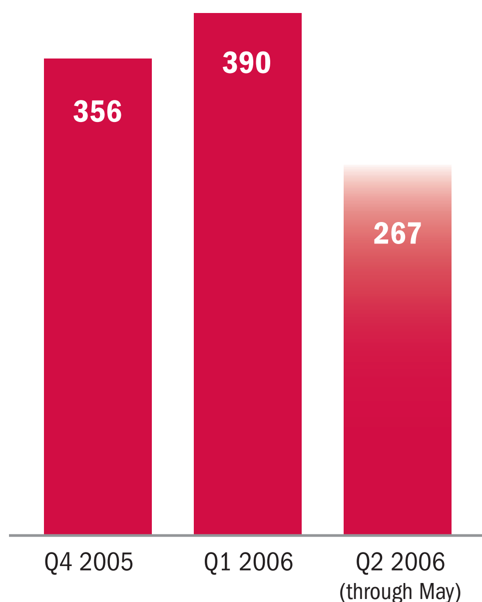
CFO.com points out that Cox did not comment on whether companies would still have to disclose the compensation of the top financial officer at the company. The plan calls for such disclosure, regardless of whether that executive is among the top five earners.

Cox's announcement comes as Congress considers throwing its hat in the ring on the compensation issue. Shareholder activists and Democrats appear to be facing off against comp consultants, CEO advocates and Republicans in the fight over whether Congress should influence how boards pay their CEOs, writes CFO.com.

The battle began at a House Financial Services Committee hearing where Democrats and shareholders called for increased disclosure and accountability, according to CFO.com. On the other side of the argument, Republicans argued in favor of letting market forces continue to drive pay.

STATISTIC OF THE WEEK

Director Departures on the Rise



Notes: Departures include resignations, retirements and those directors who left the board without a stated reason.
Source: Liberum Research

IN CASE YOU MISSED IT...

...The first quarter of 2006 saw a rise in restatements as compared to a year earlier, according to *The Wall Street Journal*. Research firm and proxy advisor **Glass, Lewis & Co.** has not released its full analysis, but says the number of restatements this year is expected to fall short of last year's total.

...With **Goldman Sachs** chairman and CEO **Henry Paulson** set to become U.S. treasury secretary, the governance and nominating committee is deciding how to fill his role. While **Lloyd Blankfein** appears certain to become CEO, the board is strongly considering whether to appoint a non-executive chairman, possibly someone currently on the board, writes the *Journal*.

...A lawsuit filed by technology firm **Micrel** states that Big Four accounting firm **Deloitte and Touche** gave its blessing to a company plan to set the strike price on the option grants it doled out to executives 30 days after they were granted. Deloitte has denied the allegations and has vowed to fight the case.

What the Enron Verdict Means for Corporate Boards

With guilty verdicts handed down for **Enron**'s **Kenneth Lay** and **Jeffrey Skilling**, op-ed pages were filled with lessons learned from one of the most notorious corporate flameouts.

Some reports, like the one appearing in the *San Jose Mercury News*, insist that Enron served as an important wake-up call and ultimately made investors stronger than ever. The *Christian Science Monitor*, meanwhile, agreed with Rep. **Mike Oxley** (R-Ohio), who co-authored the Sarbanes-Oxley Act, by stating that the legislation spawned by Enron will prevent such an affair from happening again. Conversely, both MarketWatch and Rep. **Tom Feeney** (R-Fla.) ask whether it is time to review whether SOX should be rolled back or retired. And if those views weren't divergent enough, Salon.com says Enron changed nothing at all.

Central to all of these arguments is the view that there is more focus than ever on the board of directors. SOX and a tightening of listing standards from the **New York Stock Exchange** and **Nasdaq** have required boards to be much more vigilant and independent.

Former **Securities and Exchange Commission** chairman **Harvey Pitt** says the Enron verdict shows that directors and executives can no longer claim not to know what is going on in the companies they oversee and manage. He tells the *Christian Science Monitor* that such a know-nothing defense is dead.

Brent Longnecker, president of **Longnecker & Associates**, a corporate governance and executive compensation recruiting firm, told the *Houston Business Journal* that the Enron verdict is a harsh reminder for boards and corporate chiefs that they will be held accountable for their actions.

MarketWatch jumps off on that point, arguing that the message sent by the legal system not only complements SOX regulation but renders it superfluous. "The regulation isn't necessary because the legal system is working," says **Scott Richardson**, an accounting professor at the **Wharton School of Business** at the **University of Pennsylvania**. Richardson believes SOX costs too much money and punishes companies that are doing nothing wrong.

That is the sentiment behind Feeney's and Sen. **Jim DeMint**'s (R-S.C.) Compete (Competitive and Open Markets that Protect and Enhance the Treatment of Entrepreneurs) Act, which is designed to allow smaller companies to opt out of Section 404. In an op-ed appearing on the blog Real Clear Politics, Feeney credits the laws that existed before SOX with bringing Skilling and Lay to justice. His point is that SOX was not needed in this case.

Rep. Mike Oxley, left, (R-Ohio) and Sen. Paul Sarbanes (D-MD) co-wrote the corporate accountability legislation passed in the wake of Enron's collapse

Preeminent among opinions and predictions surrounding Enron's aftermath is the concern, if not the expectation, that the next scandal is just around the corner.

While SOX has made boards and the companies they serve more responsible for preventing fraud and the court system continues to punish those who break the rules, some still question whether those efforts matter. Salon.com compares SOX with putting a "Do Not Steal" sign on the dashboard of a car. It argues that greedy executives and directors determined to scam investors will still do so, regardless of the rules created to stop them.

Correction: Ratification of a company's audit firm is one of the routine issues allowed under the New York Stock Exchange's broker voting rule. An article appearing in the May 22 issue of *Agenda* ("NYSE Move Would Boost Investors' Proxy Power") implied that the rule allowed brokers to vote on shareholders' behalf to replace the company's auditor. The online version of the story has been updated to correct the error.

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Digs In *(continued from page 1)*

company has rejected the investor's demands for representation, deriding his slate as too interconnected. The slate includes **Peter May** and Peltz's son-in-law **Edward Garden**, both of whom are principals of **Trian Fund Management**, Peltz's investment company. The others are **Inov8 Beverage** chairman **Michael Weinstein** and pro golfer **Greg Norman**, who is chairman and CEO of **Great White Shark Enterprises**.

The Peltz plan calls for Heinz to cut $575 million from its selling, general and administrative (SG&A) costs, affecting everything from pensions and salaries to marketing and research and development, according to industry trade publication *Food Ingredients First*. It also calls for reducing deals, allowances and other incentives to retailers by at least $300 million.

The four-part Peltz plan consists of the following:

- Immediately reducing costs
- Spending more on marketing and product
- Focusing on key brands and regions
- Increased stock buybacks and higher dividends

The plan also calls for Heinz to focus on its best-known product. "The company should make it a mission for more people to eat ketchup with their fries and burgers," Peltz's plan states. Among his ideas is replacing the company's single-serve ketchup packets with easier-to-open peel-and-dip containers, writes the *Pittsburgh Post-Gazette*. Peltz claims that his plan could eventually raise the value of the company's stock to $81 per share, more than double its current stock price.

The Heinz board says the plan would "cripple the company," writes *Forbes*, and **Standard & Poor's** agrees. The rating service recently put Heinz on CreditWatch, but was very critical of the Peltz plan.

Analyst **Nicole Delz Lynch** told the Associated Press, "We are concerned that the company will no longer be able to improve its financial profile as planned if outside pressures cause management to pursue more equity-focused actions." Still, food industry analysts told the *Pittsburgh Post-Gazette* that they generally approved of the proposal.

Late last week, Heinz issued its own "Superior Value and Growth" plan (see box), calling for, among other things, more moderate cuts to SG&A. Increased consumption of its products is also part of the plan. Heinz executive **David Moran** told Reuters the company will save money on shipping and packaging by selling larger bottles of ketchup. Heinz agrees that ketchup sales are central to its growth, and the company is also in the process of launching a new ad campaign.

Highlights from Heinz's "Superior Value and Growth Plan"

- $355 million in cost reductions ($265 million from costs of goods sold and $90 million from SG&A)
- $1 billion in stock buybacks over fiscal 2007 and 2008
- 8% cut in workforce
- 16.7% dividend increase to $1.40 per common share
- More than 100 new product launches in fiscal 2007
- Double-digit increase in research and development funding

Heinz has also announced plans to continue to repurchase stock and is considering hiking its dividend, which already ranks second among food industry companies. It denies, however, that Peltz's proposal has anything to do with the company's plans.

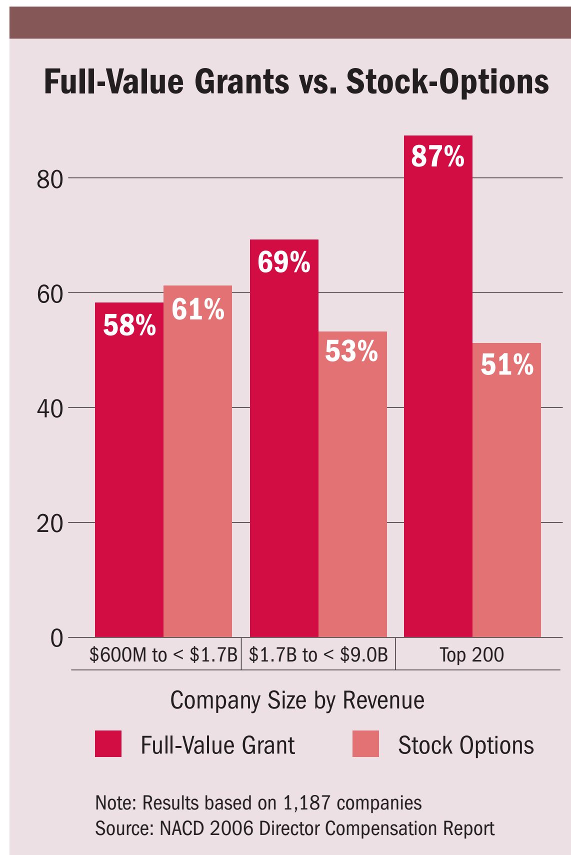
"We met with these folks twice already," Chief Administrative Officer **Ted Smyth** told *The New York Times*. Smyth says Heinz disclosed its plans to cut SG&A to Peltz during those meetings. Smyth says the investor's claims to have originated the idea are "a bit like consultants who steal your watch and tell you the time."

As the Heinz and Peltz battle goes into the heart of the summer season, investors will have a choice to make at the company's annual meeting in August. They can stick with a Heinz's plans for slower, steadier growth or take a gamble on the more radical approach offered by Peltz.

Full-Value *(continued from page 1)*

Research by Equilar shows that in the 2005 director compensation plans of the S&P 500, full-value shares were about 77% prevalent, and stock options were only about 53% prevalent. (The percentages add up to more than 100% because many companies use a combination of the two.) That compares to 2003, when options were slightly more prevalent in director pay plans.

At smaller companies, stock option use still surpasses full-value-share use, a 2006 Director Compensation Report published by the **National Association of Corporate Directors** shows. (See chart). Nevertheless, even at those companies, the margin is narrowing, the report states.



So what accounts for the increased prevalence of full-value shares in director pay packages? While companies now have to expense stock options, that is not as big a factor in the switch as some may have thought, says **Richard Alpern**, a principal at compensation consulting firm **Frederic W. Cook**.

"They're not granting that much in options to directors from an expensing standpoint," he says.

More likely, Alpern says, companies included more full-value shares in the equity portion of their director pay packages for policy reasons. Simply put, full-value options are better from an optics standpoint.

That's important, especially now, when shareholders and politicians are rallying against excessive executive compensation packages. Along those lines, any type of incentive that fits shareholders' objectives is going to gain in popularity.

Indeed, compensation committee chair **Karen Horn** says of Eli Lilly's switch to a director equity-pay package made up of full-value shares: "It better aligns directors' interests with shareholders' interests."

That's true because option grants, unlike stock grants, have value only if the stock price increases. Unlike stock options, full-value shares — whether they are granted in the form of restricted shares, deferred stock or stock whose vesting or payment isn't subject to any contingency — will always have value once directors are allowed to cash them in.

"If you're granted stock today, when it is worth $30 a share, and you get paid in a year and a half, when the stock is worth $28 a share, well, of course you're unhappy because you lost two dollars," Alpern says. "But if you had been granted options and the same numbers applied, they would be worthless."

As a result, options have more potential than shares to influence board members to do whatever it takes to hike up the company's stock price.

Most director compensation plans that use full-value shares don't entitle board members to the value of those shares immediately.

"On both of the boards that I sit on, part or all of my compensation comes in the form of restricted shares, which you get relatively quickly," says **Robert Mittelstaedt**, a director at **Laboratory Corporation of America** and **Innovative Solutions and Support**, two publicly traded companies. "In one case they vest within a few months. In the other case they vest by a third year, over three years."

The main purpose of vesting schedules for director compensation packages is usually to ensure that board members can walk away with shares only after having served for a while, according to Alpern. "That's why the vesting period is usually pretty short," he says.

Eli Lilly's director equity package, on the other hand, is intended to "give directors a long-term view of the company," according to Horn. The package is fairly unique in that the stock portion of directors' compensation packages is all in a deferred account. "They are not entitled to that part of their comp until after retirement," she says. ■

Silent Treatment *(continued from page 1)*

purpose of yelling insults and personal attacks that must simply be endured because responding would be useless," Hill says. "Most of these individuals discount the performance of the company for the long term and often focus simply on share price, perhaps because it's the only thing they really understand. The board must focus on sustaining the company for the long haul, and that goes to strategy and implementation, things that are less visible than share price but most critical to a company's quality survival."

Hill, who also serves on the boards of **Hershey's**, **AK Steel**, **Yum Brands**, **Albertsons** and **California Water Service Group**, says the hostility being displayed toward directors is like nothing she has seen before. She believes the aggression of some activists is the result of hostility fostered after the corporate scandals of the past years. She says the protests and outbursts have become personal in nature and have reached a level of virulence not present in prior years.

Home Depot's meeting is not the first this year where shareholders have voiced their frustration with management and directors through Gonzo-esque sideshows. That includes **Pfizer**'s meeting, where shareholders arranged for a small plane to buzz the meeting site towing a sign for CEO **Hank McKinnell**. The message, "Give it back Hank!" summed up shareholders' mounting frustration with what they consider to be an outsized pay package in light of the pharmaceutical company's performance.

But rather than trying to engage frustrated shareholders, some boards are ignoring those whose sole intent is to disrupt the meeting and make a bold statement.

In the case of Home Depot's annual meeting, Nardelli took only a few questions and meticulously timed the shareholders asking them, including those presenting resolutions. When their time was up, the microphone shut off, according to media reports. Shareholders making presentations were given three minutes each to present their ideas, and then Nardelli moved on to the next one. He did not provide vote tallies for the proposals or the director elections.

Those tactics have led some Home Depot shareholders to wonder why the company took such an antagonistic approach to the meeting.

"This was unusual and very irresponsible," says **Timothy Smith**, a senior vice president at **Walden Asset Management**, which sponsored a resolution about diversity on Home Depot's proxy this year and had a representative at the meeting. "It's disrespectful and arrogant for the company to freeze out the shareholders, they are the owners of the company, they have a right to come."

The board's absence at the annual meeting has raised some director eyebrows, too. According to **A. D. Frazier**, chairman and CEO of **Danka Business Solutions**, directors need to be at the annual meetings listening to shareholders' questions.

"It seems inconceivable to me that one would have an annual meeting without giving the opportunity for shareholders who have taken the time to come to the meeting to be heard," he says. With regard to directors who do not show up for meetings, Frazier adds, "That is an outrage. Directors need to show up and stand to be questioned themselves. Directors are the representatives of the shareholders."

Frazier serves as chairman of **Gold Kist**, a $2.3 billion chicken production and processing company, and also serves on the board of **Apache**, a publicly traded gas exploration company. In addition he is a former chairman and CEO of the **Chicago Stock Exchange**.

Home Depot, for its part, issued a statement shortly after its annual meeting in an attempt to answer critics.

"While we understand that the approach we took to the annual meeting was a departure from past practice, it should in no way be construed as either a lack of respect for our shareholders or a lessening of our commitment to high standards of corporate governance and transparency," the company stated in a release.

Home Depot is far from alone in its approach to the annual meeting this year. In fact, other companies including **Whole Foods**, **Halliburton**, **Weyerhaeuser** and **InfoUSA** have attempted to limit the length of the meetings through rigorous and sometimes draconian measures.

In the case of Halliburton and InfoUSA, both companies changed the location of their annual meetings shortly before they were to be held, moves that some viewed as an attempt to limit shareholder participation. Weyerhaeuser and Whole Foods took measures to muzzle their shareholders by asking them to submit questions in writing rather than taking them from the floor and not allowing shareholders to present their resolutions, respectively.

A report published by **The Conference Board** in 2004 prescribed several practices that could help improve the environment and the relevance of the annual meeting, including establishing a practice of rolling annual meetings, in which meetings are held throughout the year to help head off any controversial issues that might erupt at the annual meeting. ■

Should Boards Be Required to Monitor Contingency Plans?

While populations need to be ready for all types of crises, **Hillenbrand Industries** and **Northwest Airlines** have ongoing dialogues about their disaster contingency plans. The plans account for the possibility that operations will be interrupted, business locations destroyed and key personnel lost. The terrorist attacks of 2001 and Hurricane Katrina last year underscored the importance of companies' having solid contingency plans in place.

At the same time, a debate has recently arisen about whether contingency planning should be a function mandated by Sarbanes-Oxley. While SOX is silent on the issue of contingency planning, and the **Public Company Accounting Oversight Board**'s Auditing Standard No. 2 explicitly states that it is not an internal control, the practice could fall loosely under a certain category of SOX, especially Section 409, which governs the timely release of financial statements. Companies that experience some kind of crisis and catastrophic loss of data may find themselves at a loss when it comes to filing their statements on time. Critics say that adding another aspect to compliance will only drive costs up higher, especially having contingency planning fall under the umbrella of Section 404.

As it stands, contingency planning covers a wide range of situations, from terrorist attacks to union work stoppages. Contingency plans are also included in many companies' business plans, as part of dealing with the possibility that management's assumptions about business operations prove to be incorrect, according to **Herman Cain**, a director with **Whirlpool**, **Aquila** and **AGCO**.

Many boards are in a constant state of flux with their contingency plans, updating and changing the originals to address new challenges. Hillenbrand Industries and Northwest Airlines, for instance, both created contingency plans to deal with union work stoppages. Hillenbrand has so far been able to avoid a strike, but as collective bargaining continues this year, the contingency plan is set for implementation just in case. At Northwest, a slide into bankruptcy last year led to the employees' union rejecting a new contract and walking out, at which point the contingency plan kicked in. The plan called for the hiring of replacement workers and welcoming back those union workers who crossed the picket lines as ways to avoid business interruptions.

Dan Dalton, director of the Institute for Corporate Governance at the Kelley School of Business at **Indiana University**, says contingency planning should be a province of the board if the plan addresses enterprise risks.

"The board absolutely must be aware of risk. [If I'm a board member] I don't need to address it at every meeting, but as a board member, if I have that kind of exposure, I want to know... about possible risks and when things are going south," Dalton says.

John Chlebowski, a director with **Laidlaw International** and **NRG Energy**, says contingency planning should not become a part of internal controls or compliance. He says the plans should be handled by management and the board should not be heavily involved in their creation unless a particular business is routinely prone to disasters.

"Although business continuity plans and IT-oriented disaster recovery plans are good and valid business practice, they just don't fall under [Section] 404 as I see it," Chlebowski says. "My logic goes back to the focus of 404 being financial reporting."

Hurricane Katrina proved devastating to many small businesses in the worst-hit areas of southern states like Louisiana, where approximately 18,000 businesses were catastrophically destroyed. But some companies with operations in the storm areas were able to survive because of strong contingency plans, including Wal-Mart, which heeded the hurricane warnings early and sent supplies like water and generators to stores in the target areas. The retail giant also assigned staff to handle aspects of the disaster, including dealing with employee issues, assessing damage to facilities and security details.

While weather-related issues are always a threat to business located in certain areas, Cain and Robert Porter, a director with Arch Coal and Stepan, say that the threat of terrorism is at the top of their list of concerns in terms of contingency planning.

"In this world terrorism, companies are developing contingency plans related to terrorism," Cain says. ■

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