

Compensation Committee Structure, Function and Best Practices

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Areas of Practice

Mr. Wood's practice is focused on executive compensation, including the corporate governance tax, ERISA and federal securities law aspects of executive compensation programs. He has worked with management and with board compensation committees to design appropriate executive compensation programs and resolve critical legal and practical issues involved with such programs. Mr. Wood has designed executive employment and severance agreements, retention and change of control agreements, incentive arrangements, stock compensation plans and deferred compensation plans for private and public companies of all sizes, including startup companies and large public companies. He also counsels public company clients with respect to corporate governance practices and Sarbanes-Oxley Act compliance. Mr. Wood has had extensive experience with the compensation-related aspects of corporate transactions as well as with leveraged buyouts and other transactions involving employee stock ownership plans (ESOPs). His ESOP experience involves over 50 ESOP transactions, including several of the largest ESOPs ever formed in the United States. Mr. Wood's practice also includes the design and legal compliance of tax qualified plans such as 401(k)s, profit sharing plans and defined benefit pension plans, as well as non-qualified deferred compensation and supplemental executive retirement plans.

Professional Background

Mr. Wood is the author of several articles on executive compensation issues and has been a frequent speaker on a variety of compensation-related topics. Mr. Wood published two chapters in the *Sarbanes-Oxley Planning & Compliance* book in November 2003. He has been selected by his peers for inclusion in *Pennsylvania Superlawyers*. Mr. Wood has received an AV® rating from Martindale-Hubbell, its highest rating.

Professional/Civic Activities

American Bar Association (Business Law and Taxation Sections)
Executive Compensation Subcommittee of the ABA Taxation Section
Allegheny County Bar Association
The ESOP Association
The National Association of Stock Plan Professionals
The National Center for Employee Ownership

Bar Membership

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Introduction

These are difficult times for individuals who serve as members of boards of directors of public companies. The spate of high profile corporate scandals that have occurred over the past few years, such as Enron, WorldCom and Tyco, have brought into sharp focus the role of the board in the direction of company management and operations.

No aspect of board activities has received more scrutiny or criticism than the compensation committee. There is a widespread view in the investment community that compensation committees have largely failed to serve as an effective and independent check on executive compensation practices. Many institutional investors view compensation as a “window” on the overall quality of a company’s corporate governance practices, and the picture they see is not always pleasing.

Several interest groups and commentators on corporate governance have issued so-called “best practice” guidance for compensation committees. These include The Business Roundtable’s *Executive Compensation: Principles and Commentary* (November 2003) (the “Business Roundtable Report”), the *Report of the National Association of Corporate Directors Blue Ribbon Commission on Executive Compensation and the Role of the Compensation Committee* (2003) (the “NACD Report”) and The Conference Board’s *Compensation Committee of the Board: Best Practices for Establishing Executive Compensation* (2001) (the “Conference Board Report”). Additional criticisms of, and suggested procedures for, compensation committees were offered in the written report (the “Breen Report”) of Richard C. Breen, who served as Corporate Monitor for WorldCom/MCI, and in the three reports (the “Thornburgh Reports”) issued by former U.S. Attorney General Dick Thornburgh, who was appointed as Examiner in the WorldCom bankruptcy. Some of these suggested “best practices” have been made mandatory in the new corporate governance rules of the New York Stock Exchange (“NYSE”) and The NASDAQ Stock Market, Inc. (“Nasdaq”), discussed below.

This article is intended to assist compensation committees in the discharge of their responsibilities by providing (1) an overview of the new NYSE and Nasdaq requirements, (2) a brief summary of the legal duties and responsibilities of compensation committee members and (3) a synthesis of key aspects of the various “best practice” guidelines for compensation committees. This article is not intended to provide legal advice or to suggest that conduct contrary to any of the general principles discussed in this article will necessarily result in a violation of the law or otherwise be inappropriate. In addition, in describing the emerging “best practices” for compensation committees, neither the author nor Kirkpatrick & Lockhart Nicholson Graham LLP intends to endorse any particular practice. Compensation committees must decide for themselves which approach to executive compensation design and review best suits their respective companies’ circumstances.

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Self-Regulatory Organization Rules (NYSE and Nasdaq)

On November 4, 2003, the Securities and Exchange Commission (the “SEC”) approved long-awaited changes to the listing standards of the NYSE and Nasdaq.¹ These listing standards impose a number of new requirements aimed at enhancing the corporate governance of public companies. Generally, both sets of rules require listed companies to have a majority of their boards comprised of independent directors. In addition, the rules impose significant responsibilities on listed companies’ compensation committees (as well as their nominating and audit committees).

NYSE Compensation Committee Requirements

NYSE Rule 303A.05 requires listed companies to have a compensation committee composed entirely of directors meeting the independence requirements set forth in the NYSE rules. In addition, each compensation committee must have a written charter that addresses at a minimum the following:

- The committee’s purpose and responsibilities, which must include the compensation committee’s direct responsibility to:
 - review and approve goals and objectives relevant to CEO compensation, evaluate the CEO’s performance in light of those goals and objectives, and, either as a committee or together with the other independent directors (as determined by the board), determine and approve the CEO’s compensation level based on this evaluation,
 - make recommendations to the board with respect to non-CEO compensation (“non-CEO refers to persons who are “officers” for purposes of Section 16 of the Securities Exchange Act of 1934, as amended), incentive compensation plans and equity-based plans, and
 - produce a committee report on executive compensation as the SEC requires to be included in the company’s annual proxy statement or annual report on Form 10-K.
- An annual performance evaluation of the compensation committee.

The charter must be posted on the company’s website, and the company’s Form 10-K annual report must disclose such availability and state that the charter is available in print to any shareholder upon request.

Nasdaq Compensation Committee Requirements

Unlike the NYSE rules, the Nasdaq rules do not require the formation of a compensation committee. Instead, Nasdaq Rule 4350(c)(3) provides that the compensation of a company's executive officers must be determined, or recommended to the board for determination, either by:

- a majority of the independent directors, or
- a compensation committee comprised solely of independent directors.

There is an exception providing that in the event a compensation committee is comprised of at least three members, one non-independent director may be appointed to the compensation committee, and may so serve for a period of no longer than two years, if:

- neither the director nor any family member is a current officer or employee of the company,
- the board, under exceptional and limited circumstances, determines that such director's membership on the committee is required by the best interests of the company and its shareholders, and
- the board makes certain proxy statement disclosures.

A CEO may not be present during the voting for or deliberations about the CEO's compensation but may be present for the voting or deliberations regarding the compensation of the other executive officers.

Legal Obligations of Directors

General

Regulation of corporate governance historically has been the province of the states. Each state has its own business corporation law that governs many aspects of corporate operation, from the issuance of shares to the structure and function of the board of directors and its committees. Until recently, the primary role of the federal government, through the SEC, has been to promote full and fair disclosure by companies to their investors. With the enactment of the Sarbanes-Oxley Act (“SOX”),² the federal government has taken on a greater role in regulation of corporate decisionmaking and operation. SOX was designed to increase government oversight of financial accounting professionals and practices and to place greater emphasis on corporate governance and accountability, particularly with respect to public reporting obligations.

The legal obligations and potential liabilities of compensation committee members for their decisions regarding executive compensation are generally determined by the laws of the company’s state of incorporation. While state business corporation laws on the whole have not changed much in response to recent concerns regarding board and compensation committee governance, there has been a perceptible change in the attitudes of state judiciaries, particularly in Delaware, toward board and committee oversight of executive compensation. This change is reflected in several recent court cases as well as in public comments of key members of the Delaware judiciary.

Set forth below is an overview of the legal standards applicable to directors and compensation committee members with respect to the approval and monitoring of executive pay programs under Delaware law. While the laws of many other states are similar to Delaware’s in this regard, there are differences among the states, and directors of companies incorporated in other states should understand the applicable state’s requirements.

Duty of Care

Delaware law requires a director to exercise “that amount of care which ordinarily careful and prudent men would use in similar circumstances.”³ This duty obligates directors to make informed decisions based on all material information reasonably available to them and to critically assess that information. Perfunctory and hastily-called meetings and rubber stamp approvals cannot be expected to meet the requirement that directors’ actions be well informed and deliberate.

In carrying out their duties, directors are entitled to rely in good faith on information, reports and statements provided by officers and employees of the company and professional advisors, such as outside attorneys and consultants, as long as such advisors are selected with reasonable care for their expertise.⁴ The compensation committee may not, however, abdicate its decisionmaking responsibility. The proper role of experts is to provide information and guidance to the committee, particularly with respect to complex compensation plans and arrangements.

It is the compensation committee’s responsibility to ensure that advisors have the necessary expertise in the areas of compensation under consideration by the committee. When appropriate, directors should meet independently with the advisors, and if directors have significant concerns regarding the degree to which any advisors retained by management are actually independent of management, the committee should consider retaining its own advisors. The corporate governance rules of the NYSE require that the compensation committee have the sole authority to retain and terminate compensation consultants and to approve the fees and other retention terms of such consultants.

Duty of Loyalty

Each director must exercise his or her authority in a manner designed to further the best interests of the corporation and its shareholders, not the personal interests of the director. When a director stands on both sides of a transaction, *i.e.*, has a conflict of interest, special precautions should be taken to protect the company’s interests. The interested director should make full disclosure to the other members of the board of all material facts relating to the matter and abstain from voting on the matter. Since compensation committees are typically comprised of “outside” directors, conflict of interest issues in compensation committee deliberations with respect to executive compensation arise infrequently.

Duty of Candor

In recent years, Delaware courts have recognized a duty on the part of directors to speak with candor and truthfulness in communications with shareholders. Directors should not misinform or mislead shareholders with regard to corporate affairs. Also, the federal securities laws require directors to be truthful in communicating executive compensation information in proxy statements and other securities law filings.

The Business Judgment Rule

While the duties of a corporate director appear to be quite exacting, the “business judgment rule” provides significant protection to disinterested directors, even for decisions that in hindsight turn out to be unwise. The business judgment rule creates a presumption in favor of directors that they acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the corporation. It places the burden of rebutting this presumption on the plaintiff who challenges a decision of the board.⁵ The business judgment rule does not, however, protect directors who have a conflict of interest in the matter or who do not act in good faith on an informed basis after reviewing all material information reasonably available to them.

The landmark Delaware case of *Smith v. Van Gorkom*⁶ emphasized the critical role of “process” in the judicial review of actions by directors. That case firmly established that the law provides no protection to directors who have made uninformed or unadvised decisions. Directors have a duty to inform themselves of all material information reasonably available to them. Subsequent decisions of the Delaware courts have suggested that directors have the further obligation to ensure that adequate information reporting systems are in place that are reasonably designed to provide directors with timely and accurate information sufficient to allow them to make informed judgments.⁷

The Evolving Standard

Based on the most recent Delaware case law as well as out-of-court comments made by influential Delaware court judges, it would appear that there has been a significant shift in the degree of scrutiny that the courts will apply to the review of compensation decisions by boards and their compensation committees. Chief Justice E. Norman Veasey of the Delaware Supreme Court, in a roundtable discussion of executive compensation with a panel of other experts, stated that “the changes in corporate governance that we’re seeing through the voluntary best practices codes, for example, or through the New York Stock Exchange listing requirements have

created a new set of expectations for directors” and indicates that “this is changing how the courts look at these issues.”⁸

What is this “new set of expectations for directors?” At a minimum, the courts will expect compensation committees to put in place all of the structural and procedural safeguards mandated by SOX and the NYSE and Nasdaq rules, as applicable (*e.g.*, adoption of a charter, committee membership limited to independent directors, etc.), and to strictly abide by these procedures as written. Further, directors will be expected to ensure that they have taken all reasonable steps to inform themselves, have devoted sufficient time to consideration of the information and, where appropriate, have sought advice from relevant experts and counsel. The business judgment rule will not protect directors who fail to make a good faith effort to confirm that actions it approves are in the best interests of the company.

A recent Delaware case that gives an indication of this “new set of expectations for directors” is the decision *In re Walt Disney Company Derivative Litigation*.⁹ The case involved a shareholder challenge of the approval of The Walt Disney Company’s employment and severance contracts with Michael Ovitz, who was hired by Disney as its president. Mr. Ovitz, who was a close friend of Michael Eisner, the CEO of Disney, had no experience as an executive of a publicly-owned entertainment company prior to his hiring by Disney. Within a short period of time after his hire, it became evident to all that Mr. Ovitz was not the right person for his position.

The plaintiffs in the case alleged that the compensation committee of Disney’s board had, in effect, abdicated its responsibility to oversee the terms of the hiring of Mr. Ovitz. Among other things, the plaintiffs alleged that the compensation committee spent less than 20 minutes considering Mr. Ovitz’s employment, failed to review the draft employment agreement and any materials showing the potential payout to Mr. Ovitz under the contract, failed to retain an expert to assess the terms of employment and delegated to Mr. Eisner the authority to approve the final terms and conditions of the contract without further approval by the committee or the board. In fact, the final employment agreement as approved by Mr. Eisner differed significantly from the terms summarized earlier for the compensation committee.

When Mr. Ovitz decided that he wanted to leave Disney, he realized that an outright resignation might subject him to liability for damages to Disney and might not have entitled him to severance benefits upon his termination. With little input from the compensation committee, Mr. Eisner and Mr. Ovitz ultimately negotiated a lucrative severance arrangement for Mr. Ovitz. In his opinion in the case, Chancellor William B. Chandler, III of the Delaware Court of Chancery acknowledged his

hesitancy to second-guess the business judgment of a disinterested and independent board of directors. He found, however, that the facts alleged by the plaintiffs in the case suggest that the Disney directors “failed to exercise any business judgment and failed to make any good faith attempt to fulfill their fiduciary duties to Disney and its stockholders.” He further stated that the alleged facts imply “that the Disney directors failed to act in good faith and meet minimal proceduralist standards of attention.”

Admittedly, the alleged facts of the Disney case present an egregious example of poor corporate governance. Disney’s compensation committee appears to have simply failed to engage itself meaningfully in the processes that led to the hiring and termination of Mr. Ovitz. The case illustrates, however, the high level of scrutiny that courts are likely to apply in the future to allegations of lack of good faith by boards and compensation committees in executive compensation matters.

The courts have also been taking a more careful look at whether directors are sufficiently “independent” to qualify for the protection of the business judgment rule. As noted above, historically the courts have limited the factors that would impact a director’s independence to those factors that would provide a direct and significant economic benefit to the director. Increasingly, however, courts are examining whether there is *any substantial reason* that a director may be incapable of making a decision with only the best interests of the corporation in mind. For example, in recent cases involving the actions of special litigation committees established by the boards of directors of Oracle Corp. and HealthSouth Corporation, courts found that interpersonal connections such as shared ties with respect to a sporting organization or university may cast doubt on the independence of directors.¹⁰

The most recent Delaware case on this subject, *Beam v. Stewart*¹¹, suggests, however, that the independence standard in the special litigation committee context is, at least from a procedural standpoint, different than standard that is applicable in other contexts. The *Beam* case involved a plaintiff derivative action regarding the allegations of insider trading against Martha Stewart. The plaintiff in the case argued that demand upon the company’s board of directors to pursue the claim was futile based on the lack of independence of certain members of the board. The plaintiff asserted that certain directors were interested in the matter based upon their social and personal ties with Martha Stewart. The opinion in the case, authored by Chief Justice Veasey, stated that the independence standard is different in the demand futility context than it is in the special litigation committee context, noting that in challenging the independence of a special committee, the special committee itself, not the plaintiff, has the burden of proof. The opinion in *Beam* indicates that mere allegations that a director and the interested person move in the same social circles, attended the same weddings,

developed business relationships and described each other as friends are insufficient to establish demand futility. In order for such relationships to raise reasonable doubt about the independence of a director, the plaintiff's allegations must support a reasonable inference that the director was more willing to risk his or her business reputation than the social relationship with the interested person.

It is important to note that the NYSE and Nasdaq definitions of "independent director," as detailed as they may be, cannot be relied upon as the exclusive test of independence for purposes of state law. In assessing a director's independence for state law purposes, a board should take account of personal friendships, prior business relationships, and even ties created by philanthropic activities between executives and board members. Such connections might interfere with, or be perceived as interfering with, the board member's objectivity in evaluating executive pay.

Impact of Evolving Standard on Exculpation and Indemnification

By statute, shareholders of a Delaware corporation may adopt a provision of eliminating or limiting the personal liability of a director for breaches of the duty of care.¹² In addition to exculpation provisions, most public companies have provisions in their articles of incorporation or by-laws providing for indemnification of directors, including compensation committee members, against liabilities that arise while serving the company. Some companies have individual agreements with directors under which indemnification rights are provided to the directors.

There are limits, however, to a company's ability to provide exculpation and indemnification to directors. For example, if a director has not acted in good faith, he or she may not be entitled to exculpation or indemnification as a matter of law. As noted above in the discussion of the *Disney* case, courts are increasingly likely to apply a high level of scrutiny to the conduct of directors. In the *Disney* case, the court found that the directors "failed to make any good faith attempt to fulfill their fiduciary duties to Disney and its stockholders." Under such circumstances, the right of directors to be exculpated from or indemnified against liability with respect to the matters at issue in that case is open to question. The non-diligent director cannot assume that he or she will be eligible for exculpation or indemnification for actions taken as a director.

Best Practices: Compensation Committee Structure

Need for a Compensation Committee

There are both legal and practical reasons for a board of directors to establish a compensation committee. As noted previously, under the new NYSE rules, listed companies are required to have compensation committees consisting of independent directors. The Nasdaq rules allow companies to either establish a compensation committee consisting of independent directors or have the independent members of the full board make key compensation determinations. Even for Nasdaq companies, however, having a compensation committee is generally recommended.

In many cases, the full board does not have adequate time to evaluate complex executive compensation issues. Having a compensation committee helps to ensure that these issues receive the deliberation and attention that they deserve. In addition, the federal tax and securities laws create an incentive for companies to have independent compensation committees. The \$1,000,000 cap on the tax deductibility of executive compensation under Section 162(m) of the Internal Revenue Code contains an important exemption that is available for performance-based compensation awarded by a compensation committee consisting of two or more “outside directors.” Similarly, certain exemptions from short-swing profit liability are available under Rule 16b-3 of the SEC for transactions in employer stock by executive officers and directors provided that the transactions are approved in advance by a compensation committee composed of two or more “non-employee directors” (alternatively, the exemptions apply if the transactions are approved by the full board of directors).

Attached to this article is a chart comparing the independence requirements of Section 162(m), Rule 16b-3, the NYSE, Nasdaq and the American Stock Exchange.

Practices vary among companies with respect to the degree of autonomy given to the compensation committee. In many cases, as discussed above, it is important for the compensation committee to have autonomy with respect to the administration of certain incentive compensation plans in order to ensure that awards under such plans qualify for the exemptions under Section 162(m) of the Internal Revenue Code and Rule 16b-3 of the SEC. Some companies give the compensation committee the power to finalize other pay arrangements on its own, without board ratification. In

other companies, final decisions lie with the full board acting on the advice of the compensation committee. It is important to note, however, that all directors are ultimately accountable for decisions regarding executive pay. Therefore, the full board should be well informed with respect to the company's executive compensation programs and the actions of the compensation committee.

Size of the Committee

Surveys have shown that the typical compensation committee is composed of from three to five members. Neither the NYSE nor the Nasdaq rules contain any requirement with respect to the number of members on a compensation committee. As noted above, however, the exemptions under Section 162(m) of the Internal Revenue Code and Rule 16b-3 of the SEC require that the committee be composed of at least two directors. Some experts have speculated that as the burden of compensation committees grows as a result of increased expectations for their work, the average compensation committee will increase in size to about five members.

Member Selection Process

Historically, board committees were established, and the members of the various committees were appointed, by action of the full board of directors. Increasingly, the corporate governance committee (sometimes called the nominating committee) is assigned the task of appointing committee members, including the members of the compensation committee. Since the governance committee is generally responsible for focusing on establishing the qualifications for board membership, it would appear to make sense to assign that committee the role of determining which independent members of the board are most suited for service on the compensation committee. The governance committee should also appoint the compensation committee chair.

Qualifications for Membership

As discussed above, courts generally will not disturb informed business decisions made by independent directors. The NYSE and Nasdaq governance rules have detailed definitions of "independence" for purposes of those rules. For state law purposes, as previously discussed, the courts have historically determined the "independence" of a director with reference to whether the director has a personal financial interest in the particular matter being considered. In most cases, a company's

non-employee directors will not have a personal financial interest in decisions regarding executive compensation. Also as discussed above, however, recent court decisions may suggest that social, civic and personal connections to management should be examined in determining director independence.

In order to take advantage of the exemptions under Section 162(m) of the Internal Revenue Code and Rule 16b-3 of the SEC referred to above, a company must limit compensation committee membership to directors who meet the exacting requirements for independence set forth in the IRS regulations and SEC rules.

In addition to assuring that compensation committee members are “independent” under state corporate law standards, the NYSE or Nasdaq rules, Section 162(m) and Rule 16b-3, it is recommended that the process of selection of compensation committee members take into account how well committee members, and the chairman in particular, are suited to debate compensation issues with the CEO. Additional qualifications can be established such as a level of general expertise and understanding of executive compensation matters and the ability to learn new areas with proper orientation.

Compensation committee members need not be experts in compensation. They must, however, be willing and able to understand the mechanics, costs, risks and other ramifications of compensation decisions. Committee members should have the resolve and skepticism to ask difficult questions and set appropriate limitations on executive pay. Diversity of professional background can be helpful in bringing useful perspectives to the deliberations of the compensation committee. There is a debate with respect to whether it is advisable to have at least one active or recently retired CEO on the compensation committee. On the one hand, such individuals would bring to the task a certain depth of knowledge of executive pay as well as operating experience in setting compensation for company executives. On the other hand, they may in some cases lack objectivity and restraint when it comes to establishing appropriate limits on executive pay.

Rotation of Committee Members

There is no requirement under the law or the rules of the NYSE or Nasdaq that membership on the compensation committee be rotated. At a minimum, committee assignments should be reviewed periodically. There is a debate over whether it is a good idea to require rotation of compensation committee members on a regular basis. Rotation would tend to bring onto the committee individuals who have a fresh perspective regarding the matters considered by the committee, but it also would

tend to cause the committee to lose members who have developed more knowledge about the company and its compensation practices. If a rotation policy is adopted, consideration should be given to having the rotation occur after an extended period of committee membership, such as after five years of service. Rotation of the committee chair might occur more frequently, such as every three years.

Knowledge and Training of Members

A compensation committee can make “informed” decisions only if the committee members have adequate background and knowledge with respect to the matters under the committee’s consideration. While outside advisors can be relied upon for their technical expertise, committee members, who bear the decisionmaking responsibility, must be sufficiently conversant with compensation concepts, techniques and requirements to be able to determine for themselves the merits of all proposed actions. There are many resources available for director education in general and compensation committee education in particular. For example, the Conference Board created a directors’ institute to provide corporate governance education for directors serving on the boards of U.S. corporations. This program provides professional educational programs for corporate board members, dealing with a wide range of important board issues, including compensation. Also, both the NYSE and Nasdaq have announced programs to provide education for directors of listed companies.

Committee Charter

As described above, the compensation committee of an NYSE-listed company must have a charter that sets forth certain duties and responsibilities of the committee. The Nasdaq rules do not impose a charter requirement. Nevertheless, every compensation committee should consider having a charter. The charter should outline the role and duties of the committee as expected by the full board. It may also include membership criteria, how the chairman is chosen, rotation policy and responsibilities for outside consultants.

Some committees include in their charters a statement of the compensation philosophy of the committee. Other committees prefer to have the statement of philosophy as a separate document from the charter. In any event, by developing a clear compensation philosophy, the committee can articulate the fundamental principles that will guide the board and the compensation committee in developing and monitoring executive compensation programs.

The committee should give careful thought to content of its charter. The drafting of the charter should involve more than “finding a good form” than putting your company name on it. The charter should be sufficiently flexible to allow the committee to address new issues as they arise. Most importantly, however, if a charter is adopted its terms should be carefully followed to avoid possible increased liability risk.

Administration of ERISA Plans

Survey data indicate that most boards of directors delegate the administration of ERISA benefit plans (*e.g.*, 401(k), pension, health insurance and other plans) to management. It should be clearly understood, however, that the ability of the board of directors and/or the compensation committee to appoint those who administer ERISA plans is itself a function that must be carried out in accordance with ERISA requirements. In another words, the board or committee must act prudently in selecting those who administer these plans and must regularly monitor the performance of those administrators.

Recent case law under ERISA underscores the importance of this monitoring function. Regular high level reviews of these plans and their administration and periodic meetings with the individuals who carry out the administrative tasks are essential for the board or committee to meet their responsibilities under ERISA with respect to these plans. Under certain circumstances, the board or committee might consider hiring a consultant to assist with this monitoring function.

Frequency of Meetings

According to survey information, compensation committees typically meet three or four times per year. With the increased responsibilities of compensation committees in the current environment, it is likely that in the future compensation committees will meet even more frequently.

Committee Access to Information

It is fundamental that relevant and timely information is an essential predicate to satisfaction of the compensation committee’s duties under the law. Therefore, it is important that information and reporting systems exist that are reasonably designed to provide the compensation committee with timely and accurate information sufficient to allow the committee to reach informed judgments with respect to matters before it. Materials should be delivered to committee members at least a week in advance of the scheduled meeting.

Committee Procedures

The NACD Report suggests the following procedures for adoption by compensation committees:

- Adopt a committee calendar for the full year, indicating which agenda items are to be discussed at each meeting. Committees should meet at least quarterly, or on a regular basis that is appropriate in smaller companies.
- When possible, avoid having the committee review important items in one sitting. If possible, have them consider items at least *twice* – once for preliminary review and input, and then for finalization and approval. This two-part review should not occur at a single meeting, but in two separate meetings.
- Ensure committee input to the committee’s agenda throughout the year, modifying items as events unfold.
- Deliver meeting materials to committee members at least a week in advance of scheduled meetings.
- Schedule executive sessions of the committee at each in-person meeting. Executive sessions include only independent directors.
- Record minutes that accurately reflect discussion during each session of the committee.
- Have the committee chair brief the full board after each meeting on important matters. (It may also be helpful for the committee chair to elaborate on some issues in a meeting of independent directors in each executive session).

Minute Taking

The most thoroughly informed and deliberative decision by a compensation committee may not be defensible unless the committee is able to prove the propriety of its deliberations and actions. It is essential that detailed and accurate minutes of committee deliberations be maintained. In addition to the basic elements of corporate minutes such as time, place, and date of the meeting, notice procedures, the list of attendees, and discussion of satisfaction of quorum requirements, the following points should be considered:

- Written materials relevant to the matters to be considered at the meeting should be circulated to board members as far as in advance of the meeting date as possible, and this fact should be noted in the minutes.
- The minutes should highlight the important elements of the discussions that occurred on each matter, including the points made in favor of and in opposition to each action or decision taken by the committee.
- If one or more experts are engaged to provide advice to the committee with respect to matters under consideration at the meeting, the minutes should describe the conclusions and recommendations of the expert. If the expert provides a written report, the report should be incorporated into the minutes.
- The minutes should reflect that a considerable amount of time was spent on important matters placed before the committee. A summary of the discussion that occurred with respect to the matter should be included.
- Abstentions and dissents from actions taken by the committee should be fully recorded in the minutes, along with the arguments offered in favor of those positions. The advantage of including contrary positions is that it will enable a reviewing court to see that those positions were fully discussed and rejected, and not overlooked.
- Minutes should be circulated well in advance of the next committee meeting and should be approved in final form at the next meeting.

Use of Outside Consultants

A highly qualified, independent compensation consultant can be immensely helpful to a compensation committee in effectively discharging its responsibilities and helping to protect individual committee members from liability for ill-informed compensation decisions. As discussed above, the compensation committee is entitled to rely in good faith on the reports of such consultants so long as the consultants are selected with reasonable care for their expertise. The committee should have the authority to hire and fire its compensation consultant as the committee deems appropriate. The NYSE rules state that compensation consultants should be hired by and serve at the pleasure of the compensation committee. This does not, however, preclude the human resources department from hiring consultants for their own more general purposes. If a compensation committee uses the same compensation consultant as management, this arrangement should be approved by the board and disclosed to shareholders.

There is a debate with respect to whether it is appropriate for the compensation consultant retained by the committee to also provide services to management. There is a legitimate concern that if management and the compensation committee both have their own compensation consultants, the compensation decision-making process may become adversarial. The establishment of executive pay programs should be a collaborative effort between the committee and management and not a matter to be debated by “dueling consultants.” There may be occasions, however, where the committee needs completely objective and independent advice from a consultant, and in those circumstances, it is appropriate for the committee to engage a consultant who has no relationship with management.

Use of Outside Attorneys

As a general matter, the compensation committee should not need its own legal counsel. In most cases, the committee can rely on the advice of the company’s general counsel as well as any outside counsel retained by the company. It is advisable for legal counsel to attend all meetings of the compensation committee.

There may be occasions, however, when it is appropriate for the compensation committee to retain separate counsel. The most common instance of this is when an employment contract is being negotiated with an incoming CEO or other key executive. In this circumstance, there may be a perception that the company’s general counsel or regular outside counsel may be influenced by a desire to curry favor with the new executive. Thus, retention of special counsel by the committee may be appropriate.

Communication with Constituencies

1. Report to Full Board

The compensation committee should keep the board regularly informed of the committee’s activities. This is usually accomplished by a verbal report from the committee chair at each regular meeting of the full board. Members of management should not attend the portion of the board meeting during which their compensation or evaluation is being discussed.

2. Communication with CEO, HR and General Counsel

The compensation committee should take full advantage of in-house resources, particularly personnel who are knowledgeable about and have responsibility for the company’s compensation structure. Obviously the CEO should have a significant role in the establishment of pay levels and programs for non-CEO executives. The

company's CFO can also be useful in providing the committee with descriptions of the financial metrics that the company uses to manage its business. These metrics may be used as part of the design of short-term and long-term incentive compensation programs for executives.

Notwithstanding the importance of clear communication between the compensation committee and management, it is essential that the committee meet regularly in executive session, *i.e.*, with no members of management being present, to discuss issues of management compensation, particularly CEO pay.

A company's in-house compensation professionals can help to protect the compensation committee by providing the committee with current knowledge of basic elements of the design and administration of the company's compensation programs. The committee chair, and possibly the other members of the committee, should meet each of the key professionals in the company's compensation function and understand their roles. It is often helpful to designate an official liaison from the compensation department to the committee. Having one person responsible for managing the flow of information to the committee should enhance the effectiveness of such communications. The liaison should be aware of the schedule of the compensation committee meetings and familiar with the data reports and information needed for each meeting. The compensation committee and the internal compensation professionals should also develop a clear understanding with regard to the use of outside consultants and as to whether each group will be using its own consultant or one consultant will serve both groups.

3. *Communication with Shareholders*

Companies should provide complete, accurate, understandable and timely disclosure to shareholders concerning all significant elements of executive compensation. Such disclosure should be transparent and understandable to stockholders. The committee should consider publicly announcing significant executive compensation decisions made by the committee (*e.g.*, approval and execution of executive employment agreements). The primary vehicle for the compensation committee to communicate with shareholders is the annual compensation committee report, described below.

Preparation of Compensation Committee Report

The disclosure rules of the SEC require that each proxy statement relating to the election of directors contain a report explaining executive compensation for the prior fiscal year. The report must be over the names of the compensation committee

members, or the entire board if there is no compensation committee. The report must articulate the compensation committee's executive compensation policies and discuss the relationship between compensation and corporate performance with respect to executives generally and the CEO in particular.

The compensation committee report is the primary means for the compensation committee to communicate with the shareholders with regard to the committee's executive compensation philosophy and decisions. In the past, these reports have tended to be "boilerplate" recitations that change little from year to year. Compensation committees should use the report more creatively to promote the board's vision for the company and to explain to the shareholders the committee's approach to executive compensation, including a statement of the committee's compensation philosophy as well as the rationale supporting key decisions the committee made in the prior fiscal year.

In addition to preparing the compensation committee report, the compensation committee should oversee the other compensation disclosures in the company's SEC filings. Disclosure should be tailored to ensure the full transparency of the nature and total cost of all forms of compensation. Particular attention should be paid to compensation arrangements with respect to which full disclosure may not be mandated under current SEC proxy rules, such as deferred compensation arrangements, retirement plans, supplemental executive retirement plans (SERPs) and perquisites.

"Peer Review" Audits

As a periodic check on its approach to executive compensation, the compensation committee should consider conducting an audit of its practices from time to time by using an independent consulting firm other than the one regularly engaged by the committee. However, it should be made clear to the consulting firm conducting the peer review audits that it will not be engaged as the committee's regular consulting firm even if the audit demonstrates that the current consulting firm has not done a good job. This will eliminate any temptation on the part of the reviewing firm to undermine the relationship of the committee with its regular consultant in the hope of dislodging the committee's regular firm.

Review of Compensation Committee Performance by Board

The NYSE listing standards require the compensation committee charter to address evaluations of the committee's performance. Such evaluations should occur at least annually. A properly conducted evaluation will cause the committee to consider improvements in the process by which it deliberates and to re-examine the substance of the decisions it has made. The NACD Report contains useful "self-assessment tools" for compensation committees.

Best Practices: Substantive Issues Faced by Compensation Committees

Establishment and Application of Performance Metrics

One of the most important responsibilities of the compensation committee is the establishment of the performance objectives by which the performance of the CEO and other senior executives will be measured. Executive compensation should be closely aligned with the long-term interests of shareholders and with corporate goals and strategies, and should reflect upside potential as well as downside risk. Performance-based incentives should reflect both business and individual accomplishments. These performance measures will typically determine, or at least substantially influence, the outcomes under various compensation programs, such as annual bonuses, long-term incentives and certain stock compensation programs. Therefore, the goals should be realistically achievable and directly related to the business strategy and financial circumstances of the company.

When corporate profits are increasing and the stock market is rising, traditional approaches to executive compensation seem to keep all constituents happy, including the shareholders and the individual executives. During more volatile times, however, a different approach to motivating and rewarding management may be required. In these times, linking compensation to strategy becomes even more important.

In designing incentive compensation programs, compensation committees should focus on establishing a much tighter linkage between company operating performance and executive compensation. Historically, companies have tended to place too much emphasis on the performance of a company's stock, which is often not closely related to the executive's contribution to the long-term value of the business.

The fortunes of a company can be affected by a number of circumstances, many of which are beyond the control of the company and its management. According to the Business Roundtable Report, however, executive pay generally should not be adjusted to take account of the occurrence of such events. Rather, compensation metrics should generally be based on the company's GAAP financial results without any adjustments.

Internal and External Equity

Compensation committees should strive to ensure that the executive compensation programs and plans they approve are fair both internally and externally. The analysis of internal fairness focuses on the relationship of executive pay at different levels within the organization. Ideally, there will not be extremely wide gaps in pay at different levels unless the gaps are justified and explained. External fairness exists if a company's executive pay programs are appropriate as compared to a peer group of companies chosen by the compensation committee. In defining the peer group, committees should use multiple criteria (such as number of employees, industry, market value and revenues), not just revenues alone.

In past years, compensation committees have tended to rely heavily on data provided by compensation consultants to “benchmark” the company's compensation programs, *i.e.*, to compare them to the compensation levels of peer group companies. While such comparisons can be useful to demonstrate that a company's compensation practices are generally in line with market standards, directors should be wary of placing too much reliance on such external measures. Appropriate consideration should be given to the company's own needs, business strategy and competitive circumstances in designing and sizing executive compensation programs.

The practice of “benchmarking” is probably responsible for many of the excesses in executive pay in recent years. For example, a company may establish a benchmark for executive base salaries at the 75th percentile rank among peer group companies. Of course, if a significant number of companies benchmark at the 75th percentile level, there will be a “ratcheting” effect from year to year that may result in steep annual increases in executive pay. While benchmarking is certainly an acceptable practice, the current trend is to consider benchmarking as only one of several factors in deciding executive pay.

Shareholder Dilution

The compensation committee must be sensitive and responsive to shareholder concerns regarding the dilutive impact of the company's stock-based compensation plans. Institutional shareholders and their advocacy groups and advisors carefully review proposals for new stock compensation plans, particularly with regard to the potential dilutive effect of the plans. There may also be specific shareholder objections to particular features of new plans that they view as unacceptable, such as stock option repricing and reload features. The most common dilution thresholds used by institutional investors are ten to fifteen percent allowable potential dilution for

“mature” companies and fifteen to twenty percent allowable potential dilution for high technology and growth firms. Some investors and advisory groups, such as Institutional Shareholder Services (ISS), use more complex models for evaluating the dilutive effect of proposed new plans.

Share Ownership Guidelines

It is increasingly common for public companies to require executives and directors to maintain an equity stake in the company. Shareholders generally encourage employee stock ownership in order to build an “equity culture” among employees. The thinking is that, as shareholders, employees will embrace shareholders’ interests and work to enhance shareholder value. Such stock ownership guidelines may include incentives to buy the company’s stock and disincentives to sell it. The NACD Report suggests the following practices with respect to executive and director stock ownership:

- Require executives to purchase at least some stock on their own, rather than receiving all their stock awards as pay over and above their base salary.
- Set guidelines for minimal ownership of stock as some multiple of salary.
- Place longer holding periods on stock acquired upon the exercise of stock options or received via grants (less any sales required to fund exercises and tax payments).
- Consider restricting the ability of executives to exercise options and/or sell stock in less than a 12-month period (except to the extent necessary to pay for the exercise price and withholding taxes). Also consider requiring executives to pre-announce stock sales at least 30 days in advance or to engage in a pre-announced program sale in compliance with federal securities laws (*i.e.*, so-called “Rule 10b5-1” trading plans).
- Consider requiring top executives to hold stock at least six months after leaving the company.

Other important components of such guidelines include the amount of stock required to be owned by individuals at different levels within the organization and identification of the types of stock holdings that will be counted for purposes of the guidelines (*e.g.*, shares owned in a 401(k) plan, option shares, restricted stock, etc.).

Not all companies believe that outside directors should be included in the company’s stock ownership guideline program because of a concern that mandated ownership guidelines may disqualify directors from being independent. Most companies, however, believe the director should hold stock to ensure that they are

properly representing the interests of shareholders. In addition, in legal proceedings, a court may be more reluctant to challenge the actions of a board on the grounds that they were not acting in the interests of shareholders if members of that board have significant stock ownership.

Employment/Severance Agreements

The compensation committee should approve all employment agreements and other contracts with key executives. The Breeden Report criticizes employment and severance arrangements creating obligations that are driven by “auto pilot formulas.” These agreements, according to the Breeden Report, result in too many cases of payments reaching tens of millions of dollars that a board may be locked into even if the executive’s performance might not warrant such a large payment. Even in the case of extremely poor performance, a departing executive may receive millions of dollars even though shareholders essentially receive nothing of value from the arrangement. To address this dilemma, the Breeden Report recommended that MCI amend its articles of incorporation to limit the maximum severance that can be paid to any employee absent a shareholder vote.

The NACD Report recommends the following practices with respect to employment contracts with senior executives:

- In hiring a new CEO from the outside, the committee should employ special counsel to prepare any employment agreement on behalf of the committee.
- If existing employment agreements are “evergreen,” with automatic extensions on certain dates unless notice is given, do not allow such renewal dates to go by without periodic review and affirmative action to extend them.
- Do not treat nonrenewal of a contract as an automatic trigger for severance pay.
- Do not extend severance benefits beyond the executive’s age 65 or the company’s normal retirement date.
- Do not “add years” on to an executive’s years of employment in order to increase the executive’s retirement package.
- Do not continue to pay active-employment benefits to executives who elect retirement during a severance period in order to start drawing a pension. A decision to retire should trigger retirement benefits, and active-employment benefits should cease.

- Before agreeing to an employment agreement, review company costs under a “worst case” severance scenario.
- Expand the definition of “for cause” termination to include violations of the company’s code of business conduct and ethics, as well as violations of its insider-trading policies.
- Condition severance payments on the executive’s agreement to standard “no compete, no raid, no sue, no tell” provisions.
- Do not extend special retirement benefits to CEOs of short tenure and undistinguished performance; make any extension of special benefits to a long-serving and honored CEO relatively short in duration.

Retention Payments

Many public companies have found it desirable at certain times to establish special retention incentives for key executives. This is frequently done in the case of companies entering bankruptcy reorganization proceedings because of the concern that uncertainties surrounding the future of the company might, absent special retention incentives, result in an exodus of key personnel. However, even outside of the bankruptcy context, a company may find itself vulnerable to losing key executives and, therefore, find it appropriate to consider establishing special retention incentives for key individuals.

It has been argued by some that retention plans have been the subject of widespread abuse and that they represent an unacceptable compensation practice of paying twice for the same employee services. In fact, the Breeden Report recommended that MCI’s by-laws prohibit the payment of retention bonuses to existing employees other than in unusual situations such as acquisitions, dispositions, facility closing or other events where the board determines that a limited retention program has a specific objective warranting its use.

Recapture of Excess Payments

Section 304 of SOX provides that if misconduct results in material noncompliance with SEC financial reporting requirements, and if as a result of such noncompliance the company is required to restate its financial statements, then the CEO and the CFO of the issuer must reimburse the issuer for (1) any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following the first public issuance or filing with the SEC of the

financial document that includes the non-compliant financial report, and (2) any profits realized from the sale of securities by the issuer during that 12-month period. Companies should consider whether it is appropriate to go beyond the requirements of SOX and insert “clawback” or “bad boy” provisions in certain of their compensation plans and arrangements. These provisions typically require repayment of compensation by executives in the event the executive is determined to have engaged in misconduct, such as malfeasance, misuse of confidential information or breach of noncompete provisions.

“Holy Cow!” Calculation

The compensation committee should understand all aspects of the compensation packages it approves and should determine the maximum payout under those packages, including all benefits. The compensation committee should understand the maximum payout under multiple scenarios, including retirement, termination with or without cause, and severance in connection with a change in control of the company.

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Comparison of Compensation Committee Member Independence Requirements

PROHIBITED RELATIONSHIPS	IRC SECTION 162(m)	SEC RULE 16b-3	NYSE	NASDAQ	AMEX
CURRENT OR FORMER EMPLOYEE OF THE COMPANY	- Director cannot be currently employed by the public company or its affiliated corporations - Director cannot be a former employee who receives compensation for prior services (other than benefits under a tax-qualified retirement plan) during the taxable year from the public company or its affiliated corporations	Director cannot be currently employed by, or be an officer of, the issuer or the parent or a subsidiary of the issuer	- Director cannot be currently employed by the listed company - Director cannot have been employed by the listed company within the last three years	- Director cannot be currently employed by the listed company or any parent or subsidiary of the listed company - Director cannot have been employed by the listed company or any parent or subsidiary of the listed company within the last three years	- Director cannot currently be an employee or officer of the listed company or any parent or subsidiary of the listed company - Director cannot have been employed by the listed company or any parent or subsidiary of the listed company within the last three years
CURRENT OR FORMER OFFICER OF THE COMPANY	Director cannot have previously served as an officer of the public company or its affiliated corporations	Norequirement	Director cannot have an immediate family member who is or within the past three years has been employed as an executive officer by the listed company	Director cannot have a family member who is or within the past three years has been employed as an executive officer by the listed company or by any parent or subsidiary of the company	Director cannot have an immediate family member who is or within the past three years has been employed by the listed company or by any parent or subsidiary of the company as an executive officer
CAPACITIES OTHER THAN AS A DIRECTOR, INCLUDING AUDITOR		Director cannot receive compensation directly or indirectly, from the issuer, or the parent or a subsidiary of the issuer, for services as a consultant, or in any capacity other than as a director, except for an amount not greater than \$60,000	Director cannot be affiliated with or employed by, and an immediate family member cannot be affiliated with or employed in a professional capacity by, a present or former internal or external auditor of the listed company within the last three years	Director cannot be or have a family member who is a current partner or have been a partner or employee of the company's outside auditor and worked on the company's audit within the past three years	Director cannot be or have an immediate family member who is a current partner or have been a partner or employee of the company's outside auditor and worked on the company's audit within the past three years
COMPENSATION FOR SERVICES OTHER THAN AS A DIRECTOR	Director cannot be employed by an entity that has received payments from the public company or its affiliated corporations for personal or professional services exceeding \$60,000 or 5% of the entity's gross revenue	- Director cannot currently be, or during the last fiscal year have been, a member of or counsel to a law firm that the issuer has retained during the last fiscal year; provided, however, that the dollar amount of fees paid to a law firm by the registrant need not be disclosed if such amount does not exceed 5% of the law firm's gross revenues for that firm's last full fiscal year - Director cannot currently be, or during the last fiscal year have been, a partner or executive officer of any investment banking firm that has performed services for the registrant, other than as a participating underwriter in a syndicate, during the last fiscal year or that the registrant proposes to have perform services during the current year; provided, however, that the dollar amount of compensation received by an investment banking firm need not be disclosed if such amount does not exceed 5% of the investment banking firm's consolidated gross revenues for that firm's last fiscal year	Director cannot have received, or have an immediate family member that received, more than \$100,000 per year in direct compensation from the listed company, other than (i) director and committee fees and pension or other forms of deferred compensation (provided that such compensation is not contingent on continued service), and (ii) compensation received by an immediate family member for service as a non-executive employee of the listed company, within the last three years	Director cannot have received, or have a family member that received, payments from the listed company or any parent or subsidiary in excess of \$60,000 during the current fiscal year or any of the past three fiscal years other than certain permitted payments, including compensation for board service, payments arising solely from investments in the company's securities, benefits under a tax-qualified retirement plan, or nondiscretionary compensation, or compensation paid to a family member who is a non-executive employee of the listed company or a parent or subsidiary of the listed company	Director cannot have received, or have an immediate family member that received, any payments from the company or any parent or subsidiary of the company in excess of \$60,000 during the current or previous fiscal year, other than certain permitted compensation, including compensation for board service, payments arising solely from investments in the company's securities, benefits under a tax-qualified retirement plan, or nondiscretionary compensation, or compensation paid to an immediate family member who is a non-executive employee of the company or of a parent or subsidiary of the company

Comparison of Compensation Committee Member Independence Requirements

PROHIBITED RELATIONSHIPS	IRC SECTION 162(m)	SEC RULE 16b-3	NYSE	NASDAQ	AMEX
INTERLOCKING BOARDS	Norequirement	Norequirement	Director cannot be employed, or have an immediate family member that is employed, as an executive officer of another company at any time during the past three years where any of the listed company's present executives serve on that company's compensation committee	Director cannot be employed, or have a family member who is employed, as an executive officer of another entity where at any time during past three years any of the current executive officers of the listed company serve on the compensation committee of such other entity	Director or an immediate family member cannot be employed as an executive officer of another entity where at any time during the most recent three fiscal years any of the executive officers of the listed company serve on the compensation committee of such other entity
PAYMENTS TO OR RELATIONSHIP WITH ENTITIES IN WHICH DIRECTOR HAS AN INTEREST	- Director or entity in which the director has a beneficial ownership interest of 50% or more cannot have received any payment from the public company or its affiliated corporations for goods and services - Director cannot have an ownership interest of 5 to 50% in an entity that received payments made by the public company in the preceding tax year exceeding an amount that is the lesser of \$60,000 or 5% of the receiving entity's gross revenue for that tax year - Director cannot be employed or self-employed other than as a director by an entity where the payments made to that entity by the public company exceed 5% of the entity's gross revenue, or where such payments exceed \$60,000 and were paid for personal services to such entity	- Director cannot be, or during last fiscal year have been, an executive officer of, or own, or during the last fiscal year have owned, more than 10% equity interest in any entity which makes payments to or receives payments from the registrant or any of its subsidiaries in excess of 5% of either party's consolidated gross revenues for the last fiscal year - Director cannot be, or during the last fiscal year have been, an executive officer of, or own, or during the last fiscal year have owned, more than 10% equity interest in any entity to which the registrant or any of its subsidiaries was indebted at end of registrant's last full fiscal year in an amount greater than 5% of the registrant's total consolidated assets at the end of such fiscal year - Director or immediate family member cannot have a direct or indirect material interest in any transaction since the beginning of the issuer's last fiscal year, or proposed transaction, involving the issuer or its subsidiaries in which the amount involved exceeds \$60,000	Director cannot be an executive officer or an employee or have an immediate family member who is an executive officer of another company (excluding charitable organizations) that makes payments to, or receives payments from, the listed company for property or services in an amount which, in any single fiscal year, exceeds the greater of \$1 million, or 2% of such other company's consolidated gross revenues until 3 years after falling below such threshold	Director cannot be, or have a family member who is, a partner in, or a controlling shareholder or an executive officer of, any organization to which the listed company made, or from which the listed company received, payments (other than those arising solely from investments in the company's securities, or nondiscretionary charitable contribution matching programs) that exceed 5% of the recipient's consolidated gross revenues for that year or \$200,000, whichever is more, for the current or in any of the past three fiscal years	Director or immediate family member cannot be a partner, controlling shareholder or executive officer of any organization to which or from which the listed company made or received payments (other than those arising solely from investments in the company's securities, or nondiscretionary charitable contribution matching programs) that exceed 5% of the organization's consolidated gross revenues for that year or \$200,000 (whichever is more) in any of the most recent three fiscal years
OTHER RELATIONSHIPS AS DETERMINED BY THE BOARD OF DIRECTORS	Norequirement	Norequirement	Board of directors must affirmatively determine and disclose its determination that the director has no material relationship with the listed company or any consolidated parent or subsidiary (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company) other than as a director. Ownership of stock is not, by itself, a bar to an independence finding.	Board of directors must not be of the opinion that the director has any relationship that would interfere with the exercise of independent judgment in carrying out the responsibilities of director. Ownership of stock, by itself, does not preclude a board finding of independence	Board of directors must affirmatively determine that the director has no material relationship with the listed company that would interfere with the exercise by such director of independent judgment

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