AGENDA

THE WEEK'S NEWS FROM OTHER BOARDROOMS

May 2, 2011 | www.AgendaWeek.com

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Global Forces Transform Succession Planning

The search is on for internationally savvy executives

by Amanda Gerut

To ensure that executives with expertise in international markets are in companies' talent pipelines, directors are reviewing the processes for identifying high-potential managers in the U.S. and abroad early on. Whenever possible, such executives are deployed in countries with opportunities for growth, often for years.

Directors say their companies' long-term success or failure depends in part on senior management's ability to develop talent around the world.

"Global companies have to have a global approach to everything that they do, particularly succession planning," says **Andrew McKenna**, nonexecutive chairman of **McDonald's**.

And since hiring a CEO is a board's most imporant responsibility, global companies need to recruit directors based in emerging markets. International experience gives a board an edge in vetting prospective CEOs and other senior leaders from those countries.

"I think if you want to send a very strong message, focus on global diversity of the board," says **Charles Holliday**, chairman of the board at **Bank of**

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A New IRS Form Brings New Risks

Large companies must reveal uncertain tax positions

by Katie Wagner

Large public companies may be boosting their risk exposure this year by complying with the **Internal Revenue Service**'s new Schedule UTP, which requires them to disclose more information about their uncertain tax positions. An uncertain tax position is any in which a company considers itself to be paying less than it may ultimately owe the IRS.

For years, FIN48 has required U.S. companies to disclose the estimated value of uncertain tax positions — or a reserve for those positions — in their 10-Ks. Now, companies with assets of $100 million or more that file audited financial statements must list each individual uncertain tax position in a new form, Schedule UTP, to be filed with their 2010 income tax returns. Specifically, they must report all positions for which the corporation or a related party has recorded a reserve in audited financial statements. They must also report any uncertain posi-

Risks continued on page 2

Risks continued from page 1

tion for which they did not record a reserve because the corporation expects to challenge it.

Some examples of uncertain tax positions include claiming tax-free treatment for a spin-off transaction, or splitting a percentage of profit with an affiliated foreign distributor.

Experts say the requirement provides a road map for an IRS audit. And they think it will lead to more exposure to tax and other risks.

"With Schedule UTP, the IRS will now have a list of the controversial issues the company has already identified, described at a high level and ranked by the size of the issue," says **Scott Knott**, a partner with the **Ferraro Law Firm**, which represents IRS tax whistle-blowers.

"As a result of this, I think the IRS will spend less time on issues that don't matter and will be more focused on the large-dollar issues," Knott adds. "In the past, you could count on them spinning wheels to look at transactions that you knew weren't issues."

Schedule UTP has already significantly affected audit committees, increasing the complexity of their risk oversight role and adding to their plate the responsibility of determining just how much detail to disclose in the new form.

Question Your Tax Pros

Tax risk has a way of bringing other risks in its wake, experts say. Besides potentially losing income to additional taxes, a company that underestimates the value of its uncertain tax positions might have to restate earnings. It might run the risk of needing costly litigation to fight the IRS. Any of these risks can damage a company's reputation.

Even if the IRS doesn't question a company's uncertain tax positions, the general public may look unfavorably on them. Just look at the outrage directed at **General Electric** since word got out that it paid no taxes for 2010 — the result of taking billions of dollars' worth of uncertain tax positions.

Milt Walters, who chairs the audit committees at **Frederick's of Hollywood Group** and **Sun Healthcare Group**, is concerned about how the new requirement will affect a company's ability to fight the IRS in court.

"With Schedule UTP, the IRS will now have a list of the controversial issues the company has already identified, described at a high level and ranked by the size of the issue."

Scott Knott
Partner, Ferraro Law Firm

"By filling out this form, you have identified areas of uncertainty," he says, "and because you have done that, you may sacrifice your litigating position. It's very possible that just the form could be the foundation of the litigation," adds Walters."

So how can a board help its company manage all of these additional risks?

To start, the audit committee, risk committee or whichever entity is responsible should ask more questions about taxes.

"Audit committees need to be questioning their [company's] tax department as well as the tax department's outside advisors," says Knott. "The audit committees should also be questioning the financial auditors who are reviewing their company's tax positions and the external auditors, because they are attesting to their company's financials in reviewing their FIN48 disclosures."

Annual reviews of the estimates and judgments used to determine a company's tax positions probably won't be sufficient, he suggests.

Boards also need to look at the big picture, making sure they understand their companies' overall tax postures.

"Taxpayers run the gamut from conservative to moderate to aggressive," says **Pamela Packard**, a retired vice chairman of **BDO USA** who serves on the audit committee of a private board. "If you're an aggressive taxpayer, you would be the most likely to be impacted by [Schedule UTP].

"What the existence of the schedule UTP does is require a company to take a second look at the likelihood of IRS disagreeing with it," she says. "There may be no change, or a company may decide that it needs to increase reserves, because there is a higher likelihood that IRS will discover and disagree with the positions taken and ultimately prevail."

What to Disclose?

One chore for audit committees and other risk managers will be figuring out exactly what to disclose on Schedule UTP. The requirement — like so many IRS rules — isn't crystal clear.

For example, a company could describe an uncertain tax position as transfer pricing related to a foreign distributor, without describing in detail the methodology it used to determine its reserve for the position.

A company can also list an individual position on Schedule UTP without describing exactly which transaction or situation it's based on, or suggesting why the position might be questionable. "If you do a lot of spin-offs, for example, maybe

you don't want to state for which spin-off you are taking an uncertain tax position," says Knott.

Other useful approaches might include overwhelming the IRS with details about your positions or being excessively vague.

Viva Hammer, a partner at **KPMG** in Washington who spent six years at the Office of Tax Policy at the **Treasury Department**, recommends that audit committees seek input from their company's public relations staff on what to include on the new form for "damage control" purposes, even though the public generally doesn't see corporate tax returns.

"This is going to cause a lot of heartburn for corporate taxpayers," Hammer says. "There is a lot of uncertainty as to what taxpayers are going to be able to divulge in this form without giving away all their secrets, so to speak."

Not all directors agree. "At my audit committee meetings... I haven't heard too much concern that goes beyond the already existing requirement to disclose uncertain tax positions under generally accepted accounting principles" says **Denny Beresford**, chairman of the audit committees at **Fannie Mae**, **Kimberly-Clark** and **Legg Mason**.

And **Mike Losh**, who chairs **Aon**'s and **TRW Automotive Holdings**' audit committees, says he doesn't expect Schedule UTP to provide the IRS with significant new information.

"This is just asking companies to share something with the IRS that they have already [disclosed]," says Losh. "If you are doing it right, there's nothing to change." ■

Katie Wagner (212-542-1243 or kwagner@AgendaWeek.com) covers executive compensation and audit committees.

Audit-Risk Intelligence

SEC Would Apply SOX 404(b) to Mid-Caps

Medium-size companies aren't off the hook when it comes to complying with a key auditing provision in the **Sarbanes-Oxley Act**. Meanwhile, the costs of complying with the provision — known as Section 404(b) — are coming down.

Those are the takeaways from a new study by the **SEC**'s Office of the Chief Accountant, Reuters reports. The April 22 study, which examines ways to reduce the Section 404(b) compliance burden for companies with between $75 million and $250 million in market capitalization, was required under last year's **Dodd-Frank Act.**

Section 404(b) requires independent auditors to report on management's 404(a)-mandated assessment of the effectiveness of internal controls over financial reporting. Under Dodd-Frank, companies with market capitalization of less than $75 million already receive an exemption from the provision. The SEC had previously allowed smaller companies multiple compliance extensions amid criticism of the rule as being excessively onerous.

The SEC recommends against exempting midsize companies from the provision, saying the loss of investor protections would not be worth the potential savings. The study also finds "no conclusive evidence" linking Section 404(b) to the decline in U.S. markets' share of mid-cap initial public offerings.

The SEC's study reaches four main conclusions based on Section 404 research:

- The cost of complying with Section 404(b), including both total costs and audit fees, has declined since regulators' 2007 efforts to reduce the compliance burden.
- No conclusive evidence links Section 404(b) to companies' decisions to leave SEC-regulated markets.
- Auditor involvement in internal controls over financial reporting is positively linked with more accurate and reliable disclosure, as well as lower restatement rates.
- Disclosure of internal control weaknesses gives investors relevant information.

Section 404(b), the SEC says, "improves the reliability of internal control disclosures and financial reporting overall and is useful to investors. The staff did not find any specific evidence [that] potential savings would justify the loss of investor protections and benefits to issuers subject to the study."

While the SEC does not recommend extending smaller companies exemption from Section 404(b) to mid-cap companies, the staff says it is still working to make compliance less cumbersome. The study notes that the agency "is taking a fresh look at several of the Commission's rules, beyond those related to Section 404(b), to develop ideas for the Commission about ways to reduce regulatory burdens on small business capital formation in a manner consistent with investor protection."

In a statement, the **Center for Audit Quality** cheered the study, calling its findings "thoughtful," according to the *Journal of Accountancy*. "We hope this study will effectively discourage further discussions around ways to dilute the investor protections contained in Sarbanes-Oxley," says **Cindy Fornelli**, the center's executive director.

— Marc Hogan

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The Chandler Era Ends in Delaware

Chancery's popular chief judge says he will retire in June

by Joan Warner

William Chandler III, chancellor of Delaware's influential **Chancery Court**, announced last week that he plans to retire in mid-June. And while the court's stance on issues of corporate governance is unlikely to undergo any radical change, observers say the chief judge will be missed by lawyers and litigants alike.

Presiding over a court that frequently rules on important business disputes — a majority of U.S. companies are incorporated in Delaware — Chandler issued scores of high-profile decisions affecting American boards. In the process he earned a reputation for "fair-mindedness and civility," says **Greg Williams**, an attorney with Delaware law firm **Richard Layton & Finger** who represented **Walt Disney**'s board before the court in 2005-2006.

In the most recent example of his balanced thinking, Chandler issued two opposite decisions on corporate anti-takeover defenses within six months. Last September, he shot down a poison pill that **Craigslist** sought to adopt against minority shareholder **eBay**. In that case, Chandler decided, Craigslist's directors pursued the defense "to punish eBay" for competing in online commerce, not "in response to a reasonably perceived threat or for a proper corporate purpose."

Then, this February, he upheld **Airgas**'s poison pill defense against a $5.8 billion takeover bid by **Air Products and Chemicals**, writing that Airgas's board had "acted in good faith and in the honest belief that the Air Products offer, at $70 per share, is inadequate."

Delaware governor **Jack Markell** will accept applications for the chancellorship until May 13, and court watchers believe the seat will be filled by June 30. Although several Delaware attorneys are rumored to be interested in the job, the smart money is on vice-chancellor **Leo Strine**, also a respected jurist.

But it's one thing to fill Chandler's seat. Filling his shoes may be another story.

"The first time I heard him speak was concerning the Disney decision," says **Suzanne Hopgood**, managing director of **NACD**'s Board Advisory Services, who has been a director at five public companies. "He gave such a wonderful presentation, he changed some of the things I do as a board member."

In that landmark decision, Chandler supported Disney's board when shareholders sued over a $140 million golden parachute awarded to **Michael Ovitz**, who collected it after just 16 months as president of the company.

Another widely watched case over which Chandler presided, in 2002, pitted **Hewlett-Packard** against dissident director **Walter Packard**, who charged that the vote approving the company's $18.4 billion acquisition of **Compaq** had been improper. Packard further accused HP of coercing shareholder **Deutsche Bank** into supporting the merger. Chandler backed the company and its board on all counts, writing that Packard had failed to prove any of his allegations, and the deal went ahead.

But Chandler's pro-business decisions often came with knuckle-raps. Even though he ruled that Disney directors acted in good faith, Chandler famously wrote in his opinion that **Michael Eisner**'s "Machiavellian (and imperial) nature as CEO… infected and handicapped the board's decision-making capabilities." Governance experts say that despite the favorable outcome for Disney's board, Chandler's scolding made an impression on comp committees across the land.

For her part, Hopgood says the judge brought home to her the importance of recording careful minutes of every board proceeding. She recalls Chandler complaining that the minutes from Disney's board meetings "didn't tell him anything. He said if they had been more complete, [the court] may have been able to dismiss [the case] as a summary judgment." Instead, it cost Disney $25 million in legal fees. "That was a ringing message to me," Hopgood says. "No more just writing down that we met at 9 and adjourned at 5."

Even critics of the Chancery Court's historical leniency toward business — incorporation revenues account for as much as a third of Delaware's total income — have appreciative words for the outgoing chancellor. "Chandler is a good guy and a smart guy," says **J. Robert Brown**, a professor at the University of Denver's **Sturm College of Law**, whose website, RacetotheBottom.org, is named for a scathing remark about Delaware's legal precedents by a former **SEC** chairman. "He's the kind of judge you want to go before."

Brown believes that if Strine becomes the next chancellor, the Chancery Court will change more in tone than in substance. Chandler's style was demure, he says, whereas Strine is more visible and outspoken, frequently giving speeches and participating in SEC roundtables. "He's much more involved in the debate on corporate governance," Brown sums up.

The bigger shift at the court, he adds, has nothing to do with who sits in the chief judge's chair. In part because **Sarbanes-Oxley** and **Dodd-Frank** have preempted state law in many areas governing business practices, "Delaware's influence has been declining," Brown says.

Furthermore, even when a case falls under the rubric of Delaware corporate law, plaintiffs can sometimes choose where to file their suits. A group of shareholders, for example, could sue in their home state, assuming its court has jurisdiction. "Which judge do you want applying Delaware law?" Brown asks rhetorically. "A non-Delaware judge. So the succession may not matter that much."

Like many a chancellor and vice-chancellor before him, Chandler, who is 60, will probably take a job in the private sector. His judgeship paid him $185,750, a salary he could easily boost by a factor of 10 in a corporate law firm.

And he worked hard for the money, churning out some 1,000 opinions during his 14 years at the head of the court. People who read them were often delighted by his broad range of references, from Shakespeare to hip-hop lyrics.

Ruling on a challenge to the $19 billion merger between **Vivendi** and **Activision** in 2008, Chandler opened his opinion by comparing "the world of M&A" to World of Warcraft, an addictively popular online role-playing game. (He upheld the merger.) The previous year, supporting **Cerberus Capital Management**'s right to change its mind about buying out **United Rentals**, he made a point of working Cerberus, the mythological three-headed beast who guarded the gates of hell, into his opinion.

"He will be sorely missed by all litigators who have appeared before him, including plaintiffs," says Williams. "And I think his imprint on the court will remain." ■

Joan Warner (212-542-1288 or jwarner@AgendaWeek.com) is *Agenda*'s managing editor.

Legal Intelligence

Supreme Court Weighs Class Action Rules

The **Supreme Court** heard arguments last week in a case that could make it substantially tougher for shareholders to pursue class action lawsuits against public companies. The justices did not clearly signal how they might rule. So Reuters reports.

The case, Erica P. John v. Halliburton, hinges on how courts should set the standard for certifying a shareholder class action in securities fraud claims.

In 2002, a coalition of investors sued Halliburton, accusing the company of financial misstatements that artificially inflated its stock price. A federal trial court in Texas dismissed the case. An appeals court concurred, ruling that a class action can't proceed until the plaintiffs prove the alleged fraud caused the stock price's fall.

Arguing for the plaintiffs, lawyer **David Boies** said so-called loss causation usually comes up later in the process, Reuters reports. The appeals court was wrongly forcing the plaintiffs, in effect, to prove their whole case at the outset, U.S. Justice Department attorney **Nicole Saharsky** reportedly added.

Justice **Antonin Scalia** challenged Saharsky's contention, according to Reuters, calling it "a crazy way to run a railroad." Justice **Ruth Bader Ginsburg**, for her part, questioned **Baker Botts** attorney **David Sterling**, who argued on behalf of Halliburton that the test used was correct.

"Your argument seems to say, to get a class certification you have to virtually prove your case on the merits," Reuters quotes Ginsburg as saying. The court is expected to rule before July.

— Marc Hogan

Comp Committees Link Bonuses to Hiring Insiders

To encourage effective succession planning, some boards use a cash incentive

by Amanda Gerut

As more companies focus on promoting from within, boards are starting to tie senior executives' bonuses to succession planning and talent development.

So far only a handful of companies directly link succession planning to portions of CEOs' and other senior executives' cash bonuses. But as companies become increasingly responsive to shareholders' concerns about succession planning, more boards are likely to adopt such incentives as a way to keep talent development top-of-mind for senior managers.

"For a board to say to the CEO that a portion of [his or her] bonus is tied to effective succession planning, that's a huge communication to the CEO about how important [directors] feel it is," says **Gary Hourihan**, a senior vice president at **Farient Advisors**.

Hourihan says about half a dozen companies disclose that portions of their chief executives' bonuses are tied to succession planning. Other boards consider succession planning subjectively when they determine compensation, although that might not show up in disclosures.

In the past, most boards have shied away from including succession planning and leadership development in incentive programs for top managers. As performance metrics, earnings per share or return on net assets are far easier to quantify. But Hourihan says shareholder scrutiny of succession planning — and investor concern that hiring an external CEO usually costs more — will likely make boards more interested in rewarding good talent development.

At the companies that already do so, the portion of the CEO's bonus linked to succession planning is often about 20%, which encourages the boss to develop an effective plan for self-replacement. Specifically, the CEO is responsible for developing a process to generate and evaluate potential CEO candidates, review them with the board, and achieve board consensus on a successor.

Last year at **AmerisourceBergen**, 17% of CEO **David Yost**'s cash bonus was tied to a leadership goal that included implementing a comprehensive succession plan. On March 14, the company announced that Yost will retire on July 1, and that president and COO **Steven Collis** will succeed him.

A board may introduce such incentives as a one-time tweak to compensation, in cases where succession planning needs immediate focus. Or it may bake them permanently into the CEO's bonus formula, along with other performance measures.

No Place Like Home

At some companies, incentives to groom internal candidates for advancement extend beyond the CEO.

For instance, during the company's 2010 fiscal year, the **Archer Daniels Midland** board asked senior leaders to focus on internal performance management and succession planning. The process included quarterly discussions with the executives' direct reports. According to ADM's proxy, effective performance management accounted for 3% of the executives' compensation packages.

Regular performance reviews among senior management promote a culture of developing internal talent. They also help the board with CEO succession planning, since directors can see which executives carry them out effectively.

Fred Steingraber, chairman emeritus of **A.T Kearney**, recently coauthored a study of leadership at nonfinancial **S&P 500** companies from 1988 to 2007. The study, "Home-Grown CEO," found that the top performers in terms of revenue growth, profit margins, earnings per share and other metrics had all developed internal CEO successors.

Yet boards often overlook leadership development when they review potential candidates for the CEO and other senior positions, Steingraber says. Boards should consider whether the executive has hired high-performing employees and whether the executive's former positions were filled by internal successors.

"Whether or not leaders understand the importance of leadership development, and how they perform in that respect, is an important benchmark," says Steingraber. "That's a very key dimension that boards have to pay a lot more attention to."

The study cites **Colgate-Palmolive** as one of several companies where compensation is structured to reward internal leadership development.

At Colgate, named officers and others review a group of high-potential succession candidates every quarter, with a goal of retaining 90%

of them. The company tracks unplanned turnover in the high-potential pool, and a third of executives' bonuses are tied to achieving the retention goal, according to the study.

Boards have also long used retention bonuses in succession planning to keep key executives who are in line for the CEO job but ultimately don't get it.

The **American Electric Power** board awarded four potential succession candidates retention bonuses in the form of restricted stock last year after current CEO **Michael Morris** announced he would retire on Nov. 11, 2011.

The board determined that if one of the four was chosen, he or she would need the other three, and, if an external CEO was hired, the new CEO would need the group of four. The board later narrowed down the group of four to three, and in late December announced that one of the three, **Nicholas Akins**, had been appointed president. He is likely to succeed Morris. ■

Amanda Gerut (212-542-1246 or agerut@AgendaWeek.com) covers succession planning, board composition and director pay.

Boards Prepare for a Vote-on-Parachute World

Proxies must include details on NEO pay ahead of a merger

by Josh Martin

New requirements for a shareholder advisory vote on golden parachutes came into force quietly on April 25. But they could lead to controversies as stormy as those unleashed by say on pay.

The **SEC**'s final rule requires companies to hold an advisory vote on golden parachutes if they make any changes to executive pay packages between their previous proxy and the time they begin a merger or acquisition process.

"It's one more issue to have on your checklist if you're doing an M&A," says **Pat McGurn**, an executive director at **ISS**.

The prospect of shareholder scrutiny under the SEC rule is likely to prompt boards to change the terms of their executive golden parachutes. The last thing a corporate marriage needs is angry shareholders. So the pressure is on to drop unpopular pay practices once used to encourage top management to support an M&A action, including special deferred and contingent payments as well as perks like tax gross-ups. A "no" vote on golden parachutes could delay and potentially even derail a merger.

The SEC spelled out the scope of the new rule in a January 25 fact sheet and issued guidance on April 1.

Proxies must now disclose all agreements and understandings that the acquiring and target companies have with the named executive officers of both companies. The only way a shareholder advisory vote can be avoided is if a company has already disclosed its golden parachute terms in the most recent proxy, subject to a say-on-pay vote, and makes no changes if it then enters into an actual M&A situation.

The new SEC rule calls for disclosure in both narrative and graphic formats, so shareholders will have no doubt about who gets paid, how much they get paid and what conditions apply. Helpfully, the rule includes a template of the graphic (see table), which has cells for the names of the five NEOs and for the components of each one's parachute, including cash, equity, pension, perks,

Parachute continued on page 8

The SEC's New Disclosure Table

Golden Parachute Compensation

Name of executive	Cash ($)	Equity ($)	Pension ($)	Perks ($)	Tax Gross-Ups ($)	Other ($)	Total ($)
Primary Executive Officer							
Primary Financial Officer							
Third Named Executive							
Fourth Named Executive							
Fifth Named Executive							

Source: SEC

Parachute continued from page 7

tax gross-ups and other payments. And there's a cell for "total."

The prospect of disclosure and shareholder votes is already having an impact on compensation design. Many boards are taking pains to strip out tax gross-ups, eliminate perks and link more parachute bonuses to performance. **Alcoa** even drew attention to an ISS comment on "improvements" to its pay and parachute plans in this year's proxy.

Compensation consultants can suggest ways to make golden parachutes more shareholder-friendly. **Margaret Engel**, partner at **Compensation Advisory Partners**, advises that directors avoid including large severance benefits, tax gross-ups on parachutes and big perks.

Proxies filed in the few days since the rule came into effect, including from companies like **North Central Bancshares**, **Alliance Data Systems**, Alcoa and **SRS Labs**, reveal that most are using the required language and format for parachute disclosure.

SRS Labs, for example, has a simplified graphic showing base pay, cash bonus and commissions, a multiplier and the resulting parachute size for each of its top five officers. The proxy also gives these executives a strong incentive to forgo any add-ons: Executives do not get their golden parachutes unless they waive severance benefits under their employment agreements. And they must make the decision within five business days after a covered termination or resignation.

Legal experts say some boards may test the rule's limits by using summaries or alternative graphics, or by changing the order in which information is presented. "I expect boards to experiment," says **Marc Trevino**, partner at **Sullivan & Cromwell**. ■

Josh Martin (212-542-1211 or jmartin@AgendaWeek.com) covers compensation and legal developments.

Stanley Black & Decker Gets a 'No' Vote on Pay

Even with solid stock performance, shareholders want the directors out of there

by Josh Martin

Memo to the **Stanley Black & Decker** board: Listen to your shareholders before they vote you out.

They came close this time around. At the company's April 19 annual meeting, shareholders dealt it both a "no" vote on executive pay and high withhold votes on all five directors who were up for reelection.

The pay vote was a lopsided 61% against and only 39% in favor — the widest margin of any negative say-on-pay vote so far this proxy season.

Shareholder returns, often the impetus behind negative say-on-pay votes, were not the issue here: Stanley Black & Decker's stock had appreciated by 26% since the 2010 annual meeting, rising from $60 to $76. Instead, shareholders focused on lingering, unresolved compensation issues, especially the incentive package offered to executive chairman **Nolan Archibald** last year, which includes three years of guaranteed equity awards and a potential $45 million performance-linked "cost synergy bonus," payable in 2013 for his ongoing role in the recently completed merger of Stanley Works with Black & Decker. Despite the merged company's good stock performance, shareholders feel Archibald's payout is excessive.

"It was the second year in a row where pay issues dominated," observes **Pat McGurn**, an executive director at **ISS**. "The board really needs to communicate with investors."

Indeed, an ISS report notes that the "no" vote on pay was at least in part a reaction to the S&P 500 company's response to last year's vote results. In 2010, compensation committee chairman **Virgis Colbert** received less than majority support, yet he remains chair of that committee.

Among the directors up for reelection this time, **George Buckley** got the best results: 64% for, 36% withheld. **Carlos Cardoso**, a comp committee member, and **Robert Coutts**, chairman of the nominating committee, each had 49% opposition.

Stanley Black & Decker's board has not issued any statement about what actions the company might take in the wake of the votes. But company spokesman **Tim Perra** points out that all five directors were elected by a majority. Regarding the say-on-pay vote results, the proxy states simply that the comp committee will take them into account when setting executive pay in the future. ■

Josh Martin (212-542-1211 or jmartin@AgendaWeek.com) covers compensation and legal developments.

Why the 'Pay Ratio' Law Must Be Rescinded

The number is a time-consuming distraction from more meaningful com

by Charles Tharp

Charles G. Tharp, *chief executive officer of the* **Center on Executive Compensation**, *explains how the so-called "pay ratio" law will divert management's time away from strategy while raising costs for companies.*

The House Financial Services Subcommittee on Capital Markets is considering legislation to remove the so-called "pay ratio" requirement from the **Dodd-Frank Act** this week. In introducing the legislation, the sponsor, Rep. **Nan Hayworth** (R-N.Y.) noted that if implemented, compliance with the ratio "will be costly and time-consuming for employers, will serve no useful purpose for company shareholders, and will divert resources from job creation."

For directors, there are legitimate concerns that the law will distract management from strategy and divert it to "busy work." Even the **Council of Institutional Investors**, a strong advocate of shareholder rights, has not come out in favor of the ratio. Congress should seize the opportunity to repeal the provision before the **SEC** proposes implementing regulations.

Why is the Dodd-Frank pay ratio so onerous? To start with, the law requires companies to calculate the compensation of all employees globally, in the same way that they calculate total compensation for named executive officers in their proxy statements. They must disclose median employee pay and the ratio of that median to total CEO compensation.

The popular perception is that for sophisticated employers, this information is available at the touch of a button. But that is not the case. Few global companies maintain payroll data for all their employees. The pay ratio requirement would force them to aggregate data from dozens, even hundreds, of countries and payroll systems covering thousands of employees. Companies will then have to account for currency fluctuations and calculate employee pay in the same format used to report compensation for named executives.

Even prominent Democrats have expressed concern that the pay ratio is unworkable. Rep. **Barney Frank** (D-Mass.), the architect of the underlying statute, said in a hearing last September that the pay ratio legislation "is worded poorly, and I am willing to change [it] because of the disproportionate amount of information asked of companies." SEC commissioner **Elisse Walter** noted that implementing the provision will, "at a minimum, be quite difficult."

Typically, where a statutory provision is vague or complex, lawmakers look to the regulating agency to use its discretion in drafting practical implementing regulations. However, **Meredith Cross**, director of the SEC's Division of Corporation Finance, which has responsibility for drafting implementing regulations, told a congressional committee in March that the provision "is very prescriptive [because] of how it is written in the statute. It doesn't actually give us leeway. It is written so that it has to be in every filing, it has to be every employee, [and] it has to be compensation as calculated under [the SEC's proxy disclosure rules] the day before the [law] was signed."

Given the government's mixed signals on this measure, it is hard for a director to see how the legislation will add value for shareholders, and how it's a good use of management's time. Beyond the exhaustive work and arguably unproductive outcomes, more pressing compliance priorities exist, such as the linking pay and performance or say on pay. Directors also may wonder whether the legislation heralds increased government micromanagement of executive pay.

In addition, the pay ratio mandate would not provide material information for investors. The standalone number will not describe anything useful about a company — even in comparison to peers — because it will vary significantly by industry, company, geographic location and business strategy. According to data from the Center on Executive Compensation tracking the 50 largest companies by market capitalization, proxy statement pay disclosures increased by 25% between 2008 and 2010. This year saw even more disclosure, thanks to say on pay. The pay ratio would only increase the size and complexity of disclosures.

Executive compensation serves an important purpose, and more can be done to improve the link between pay and performance. Repeal of the pay ratio will remove a potential distraction and allow companies to focus on more meaningful ways of strengthening that link. ■

Succession continued from page 1

America and a director with **Deere & Co.** "[It's] awfully hard to do, because people have to travel long distances. [But] that way you've got people that are familiar with other cultures and can help put things in perspective."

International diversity on the board and in a company's top positions can push a company ahead of its rivals.

"Unless a company is willing to open up the boardroom and senior executive spots to people of different backgrounds, they'll eventually reach a point where they won't be competitive anymore," says **Eugene Fife**, a director at **Caterpillar** and **Allscripts**.

Emerging Markets Rising

Economic growth over the next few decades will be concentrated in Latin America, Asia, the Middle East and possibly Africa, says **Gary Hufbauer**, a senior fellow at the **Peterson Institute for International Economics**. Those countries hold the most opportunities for U.S. companies, he adds.

As a corollary to their fast growth, many emerging markets are beginning to catch up to the U.S. in years of education — meaning that soon, they will be home to an even more highly skilled labor force. In Singapore, Hong Kong, Brazil and China, Hufbauer says, students will receive the same quality of education and number of years of schooling that their American counterparts get within 20 years.

"That has to [have an impact] on where skilled work gets done, where research and development is done, and where innovation takes place in the next two decades," says Hufbauer.

At the same time, according to "Home-Grown CEO," an **A.T. Kearney** and Indiana University study of leadership at nonfinancial S&P 500 companies, the pool of 35- to 50-year-old American executives contracted by roughly 3% during the first decade of this century after expanding for 40 years.

Taken together, these forces will have a "transformational impact on leadership development and succession management for boards and stakeholders going forward," the study states.

"The workforce shortage in our national industries is probably the biggest issue facing our country today, and in many cases it's related to leadership talent and the ability of U.S. industries to compete in the world marketplace," says **James Taranik**, a retired director of the board of **Newmont Mining** and a geological sciences professor at the University of Nevada.

'Darwinian Environment'

Many boards hold a two- to three-day meeting to review strategic plans, says BofA and Deere director Holliday. Three or four months later, they often conduct an equally extensive people review, to decide what the company needs in terms of executive talent and whether employees are well positioned to carry out the strategic plan.

"If we're talking about growing our business [by a factor of] three in Russia, are we building talent with Russian language skills and knowledge of business practices there?" says Holliday. "What I find is, that's the question really good boards are asking: Do we have the right mix?"

Boards should also work to ensure that CEOs deliver the message about international thinking and experience to senior management. Executives need to know that if they want to move up, they'll probably have to spend several years working abroad.

"It's a pretty fierce Darwinian environment out there," says **Fred Steingraber**, coauthor of "Home-Grown CEO" and Kearney's chairman emeritus. "And you need to have boards that are really on top of how that environment is changing, and asking themselves how they need to get people prepared for it."

Steingraber remarks that such preparation usually doesn't mean an idyllic year in Paris. "Going to London, Australia [or] France doesn't cut it," he says. "That isn't where the growth and the action are going to be."

David Pyott, CEO and chairman of **Allergan** and a board member at **Avery Dennison**, says that his upbringing in India and other countries gave him linguistic ability, which

Some U.S. Companies with Foreign-Born CEOs

Company	CEO	Country
Alcoa	Klaus Kleinfeld	Germany
Allergan	David Pyott	Scotland
Citigroup	Vikram Pandit	India
Hewlett-Packard	Léo Apotheker	Germany
Morgan Stanley	James Gorman	Australia
PepsiCo	Indra Nooyi	India
Pimco	Mohamed El-Erian	Egypt

Getty

Golden arches in China: McDonald's is going where the fast growth is

honed his listening skills and helps him connect with people around the world more easily.

"That ability to connect is quite a great asset," says Pyott. He adds that since he has traveled so extensively and lived in several different countries, customers quickly realize they don't need to explain from scratch how things work where they are. "They feel understood, and then you learn all sorts of wonderful things that most people in my position don't get to hear."

As CEO, Pyott says, he always makes sure all executives know that if they're willing to move, more options will come their way. "Whereas if you say you're not ready to move, or 'I wouldn't want to live in certain places,' by definition you've just said no to alternatives."

Another priority for a truly global company is making sure that employees based abroad are moving into senior management positions.

Holliday, who was CEO at **Dupont** for 11 years, says that when he visited other countries where the company had operations or offices, he communicated to executives there that senior leadership positions were open to them.

"If you want to attract the most talented people in China, they shouldn't feel that they're limited to only working in China their whole life," says Holliday. "You've got to have a development pipeline where the CEO can come from someplace other than the home country. That sends a very strong statement."

For boards, the ability to compete globally boils down to having the best talent, says Steingraber.

"A major issue about competitiveness is the war for talent and the need to have the right kind of talent with different kinds of experiences, different kinds of cultural upbringing and different kinds of backgrounds," he says. "Boards have got to be in the position of taking responsibility for overseeing the quality, quantity and effectiveness of leadership development programs companies have in place." ■

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Nom-Gov Intelligence

ISS, Glass Lewis Seek Ousters at Wells Fargo

A pair of proxy advisory firms are turning up the heat on **Wells Fargo** directors ahead of the company's May 3 annual meeting.

Both **ISS** and **Glass Lewis** are urging Wells Fargo shareholders not to reelect lead director **Philip Quigley**, the *Charlotte Observer* reports. Glass Lewis is also recommending that shareholders oppose the reelection of four other directors, among them three who joined from the **Wachovia** board when the two banks merged.

The two firms' concerns underscore how potential appearance of a conflict of interest, even one that isn't against the law, can raise flags with proxy advisors. Glass Lewis's recommendations also highlight the possible pitfalls when inheriting directors from an acquired company.

Quigley has served as lead director at Wells Fargo since January 2009, the *San Francisco Business Times* notes. While Quigley is an independent director under New York Stock Exchange rules, bank proxy filings show that his son works in Wells Fargo's wholesale banking unit, receiving $450,000 in 2010 pay.

Glass Lewis reiterated its call for an ouster of Wachovia alumni **John Baker**, **Donald James** and **Mackey McDonald**. As quoted by TheStreet.com, the proxy advisory firm points to the directors' "failure to properly oversee risk management at the bank in the years preceding the financial crisis." Glass Lewis opposes the reelection of **Cynthia Milligan** because her son and brother are Wells Fargo employees.

Wells Fargo had no immediate comment on the recommendations, according to the *Business Times*.

— Marc Hogan

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IN THE NEWS

Frank: No Rush to Meet Dodd-Frank Deadlines

A coauthor of the massive **Dodd-Frank** financial overhaul law had some reassuring words last week for regulators falling behind on meeting the law's implementation deadlines. "There is no penalty for not meeting the deadline," Rep. **Barney Frank** (D-Mass.) told a group of lawyers during an April 26 webinar sponsored by the **National LGBT Bar Association**, according to an *Investment News* report. "Nobody gets fired."

While the law calls for regulators to write rules for hundreds of its provisions by July 21, Frank signaled he's OK with delays if agencies need more time, *Investment News* reports.

More than 100 Dodd-Frank mandates fall under the purview of the **SEC**, including regulations for say on pay, proxy access, clawbacks and mandatory independence of compensation committees. The commission has postponed implementing a range of the law's measures, most recently including provisions affecting the oil and mining industries. Also pushed back were the creation of a whistle-blower office and four other new offices called for under Dodd-Frank.

Legislation proposed by Republicans on the House Financial Services Committee would postpone implementation of Dodd-Frank's derivatives provision until December 2012. Frank said he is against that, *Investment News* reports. "What you have is complaints from people who were against [Dodd-Frank] in the first place," he is quoted as saying.

Marsh Offers New D&O Insurance

Marsh has rolled out a new insurance product for directors and officers that could come in handy at some financial companies.

The insurance broker's new FDIC Receivership Endorsement seeks to address new liability issues posed by the **Dodd-Frank Act**. The financial overhaul law allows any too-big-to-fail financial company that's deemed on the brink of failure to be put into receivership with the FDIC. As a receiver, the FDIC can conduct investigations, claw back executive pay, repudiate contracts and sue directors, among other powers.

Machua Millett, senior vice president in Marsh's financial and professional liability practice, tells *National Underwriter* that the new offering is an endorsement to a company's D&O "Side A" coverage. The endorsement would ensure that directors and officers receive payment even if the FDIC repudiates a contract or claws back part of their compensation, Millett says.

WCD Honors P&G, Coca-Cola, Kraft

Procter & Gamble, **Coca-Cola** and **Irene Rosenfeld**, chairman and CEO of **Kraft**, are all recipients of **WomenCorporateDirectors**' first-ever WCD Visionary Awards, the global group of 1,000 women directors said last week.

WomenCorporateDirectors, or WCD, is giving the awards in conjunction with its first Global Institute, an invitation-only conference of women corporate directors set for May 17 and 18 in New York.

"It's about greater performance," says **Theravance** director **Henrietta Holsman Fore**, co-chair of WCD, in a statement. "Companies with more women directors are outperforming their peers."

P&G, which has five women on its 11-member board, will receive the WCD Visionary Award for Leadership and Governance. Coke, which has made a commitment to the sustainability of water resources, will receive the WCD Visionary Award for Innovation in Shared Value. The WCD is giving the WCD Visionary Award for Strategic Leadership to Kraft's Rosenfeld in recognition of "her leadership in making strategic decisions, and for her courage in making long-term and short-term strategic investments," including Kraft's acquisition of **Cadbury**. ■

—Marc Hogan

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