

Acredula

Current Trends in Boardrooms, Executive Suites Focus of Upcoming Conference

BRICKER & ECKLER LLP

100 South Third Street
Columbus, Ohio 43215-4291
(614) 227-2300
FAX (614) 227-2390

info@bricker.com
www.bricker.com
www.BoardandExecutive.net

Bricker & Eckler LLP's *Acredula* is available to clients and friends of the firm, and highlights information of particular importance to boards and executives. The information contained in this newsletter is not to be construed as legal advice or opinion.

We invite you to photocopy and distribute this newsletter as you wish. Or, request additional copies from us.

Acredula is the Latin word for "owl," connoting wisdom. This newsletter is intended as wise counsel for boards and executives.

Continuing our focus on matters of importance in the boardroom, this issue examines the current trends in compensation, governance, liability, and disclosure and reporting affecting both the boardroom and the executive suite. This edition reviews the current trends discussed at the 2000 Spring Meeting of the American Bar Association's Section of Business Law, held March 22-26 in Columbus. It also previews the trends that will be discussed at the "Building a Better Board" conference for CEOs and their independent directors hosted by The Ohio State University on September 14-15, 2000 at the Fisher College of Business.

Bricker & Eckler LLP is co-sponsoring the "Building a Better Board" conference, which will kick off with a keynote address by G. Richard Wagoner, President and CEO of General Motors Corporation, at a dinner held on September 14. Panel discussions will be held through lunch on September 15, and will be led by:

- R. Dimon McFerson, President and Chief Executive Officer of Nationwide Enterprises;
- Dana G. Mead, Chair, President of Tenneco Automotive Inc.;
- Karen L. Hendricks, President and Chief Executive Officer of Baldwin Piano & Organ Company;
- John H. Biggs, Chair, President and CEO of TIAA-CREF;
- Candice Carpenter, Co-Chair and CEO of ivillage, Inc.;

Editor's Note

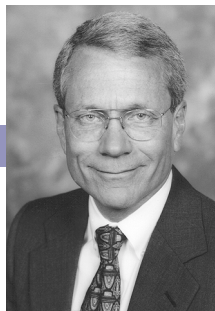
- Peter N. Larson, Chairman of the Board and Chief Executive Officer of Brunswick Corporation;
- Thomas R. Anderson, Executive Director of Ohio School Employees State Retirement System; and
- Ira Millstein of Weil, Gotshal & Manges LLP.

The panels will discuss:

- Current trends in boardrooms and executive suites;
- The view of institutional investors on governance and compensation issues with commentary from executives and board members; and
- How e-commerce companies are building boards, presented by Candice Carpenter from commentary culled from executives and board members of more traditional companies.

For further information, contact Carol L. Newcomb at:

The Ohio State University
110 Pfahl Hall
280 West Woodruff Avenue
Columbus OH 43210-1144
(614) 292-0268
newcomb.28@osu.edu



John P. Beavers
Partner,
Bricker & Eckler LLP

What's New in the boardrooms and executive suites of American business

By the end of the year, Ohio will have hosted several key events examining current trends in the boardrooms and executive suites of American business. One important event was the 2000 Spring Meeting of the American Bar Association's (ABA) Section of Business Law, held March 22-26 in Columbus. Another major event is the "Building a Better Board" conference for CEOs and their independent directors hosted by The Ohio State University on September 14-15, 2000 at the Fisher College of Business. This article will review the current trends discussed at the ABA Spring Meeting and preview those that will be discussed at the upcoming OSU conference.

Compensation

Nonqualified Stock Options. While stock options have been and are widely used to compensate executives of for-profit organizations, common misperceptions have limited the creative use of nonqualified stock options. One misperception is that the exercise price of an option has to be the market price at the date the option is granted. This is not true. Many employers are making creative uses of options that have an exercise price as low as 25 percent of the market price. These options are generally known as "discount" options. Another misperception centers on the notion that options may only be granted to purchase employer stock. Again, this is not true. An option can be granted for the purchase of any property. Many employers are using options to purchase mutual fund shares, real estate, and patent rights. Most recently, non-profit organizations have started using nonqualified stock options in property other than employer stock to close the gap in executive compensation between non-profit executives and their for-profit brethren.¹

Change-in-Control Compensation. E-commerce, health care, and communications companies are experiencing the same consolidation that financial services, energy and other business segments have previously experienced. The board of an organization that is considering consolidation faces the problem of retaining its CEO through the consolidation's completion. Most organizations will have

difficulty completing a consolidation without the leadership of their CEO. For this reason, boards are adding golden parachute provisions entitling the CEO and other key executives to additional severance pay upon discharge without cause or to quit for good reason after completion of a change in control. The trick in negotiating and drafting these provisions is making the severance arrangement attractive enough to retain the executive through the consolidation, but not so unattractive to become a deterrent to a possible consolidation. A future issue of *Acredula* will focus on these issues.



John P. Beavers
Partner,
Bricker & Eckler LLP

Front-End Planning to Retain Executives. Many employers are coming to the conclusion that

tail-end outplacement benefits have much less value in retaining key executives than front-end planning benefits. As a result, employers are re-thinking the package of perquisites offered to key executives in an effort to encourage their retention rather than promote their departure. These employers have found that they receive "double" value in helping executives with personal investment, compensation, estate, and financial services over their careers. The executive will not only be better assimilated with the employer and the community, but will also have more time to focus on employer and community activities. Often these services include assisting executives with planning for:

- Education savings;
- Retirement savings;
- Tax minimization;
- Survivor protection;
- Estate succession and transfer; and
- Asset protection.

A future article of *Acredula* will focus on these front-end planning services as a tool for retaining executives.

Intermediate Sanction Limitations on SERPs. Several tax-exempt organizations are re-examining executive compensation in light of the Intermediate Sanctions Act and §4958 of the Internal Revenue Code. One target is the supplement retirement arrangement (SERP). Traditionally, many

organizations have grossed-up the compensation of their executives with SERPs in order to cover those executives' tax liability for having to include the SERPs in current income after they were no longer subject to substantial risk of forfeiture. As a result of §4958, many compensation consultants are reducing the SERP benefit by the annuitized value of such gross-up and, in some cases, recommending further reduction of the SERP benefit to assure meeting the comparability test required under §4958.

Governance

Growth in the Independent Composition of Boards. One of the prevalent trends in corporate America is more focused oversight by increasingly independent governing boards composed of members with more diversified skills and experience. Non-profit organizations, especially in health care and education, have led the trend toward independence, and their governing boards today are almost entirely made up of members who are independent of management. Publicly held companies have followed suit.

As a result, the only employee on most of the largest publicly held companies' boards today is the CEO. This trend is now common among all organizations where management is separate from ownership. Surveys show that, since the early 1980s, the average board size of privately held, mid-cap companies has increased from five to seven members and the average number of independent members of these boards has increased from one to four. Today, on average, a majority of their boards' composition is now independent. There are two principal reasons for this. The first is access to capital markets: Capital markets require active oversight and greater independence on the part of boards of all organizations, especially those that are privately held. The second is to add core competencies: Management, especially of privately held organizations, is finding value in recruiting board members who possess the core skills that the existing team lacks. A future [Acredula](#) article will focus on this trend.

More Focused Oversight by Boards. The traditional role of any organization's governing board is a combination of

oversight and mentoring. The capital markets have forced boards to better articulate their oversight role. Recognizing the importance of allowing organizations the flexibility to adjust to a fast-changing, more competitive economy, investment bankers, lenders and other providers of capital have, since the early 1990s, required less financial and restrictive covenants for organizations that have active governing boards, where the majority of the members are independent. Rather than rely on financial and other restrictive covenants in underwriting, loan and other capital agreements, these providers of capital are instead requiring oversight of an organization's audit function and management compensation by formalized committees of the organization's governing body. As a result, audit and compensation committees are becoming the key oversight committees of every governing board. Audit committees help to assure the presence of internal accounting controls to provide not only accurate financial information, but also an independent review or audit to verify accuracy. Compensation committees help to prohibit excess compensation and benefits to management. In December 1999, the

AICPA, SEC, NYSE, AMEX and NASD all adopted rules regarding the oversight function of governing boards of publicly held companies, as a condition to having access to public security markets. At the same time, lenders and other providers of capital required similar oversight by governing boards of privately held companies, as a condition to receiving capital. The June 2000 issue of [Acredula](#) will focus on this trend.

Not Allowing Corporate Compliance to Separate the Board from Management. Reacting to the Congressional drive to criminalize certain fraudulent business conduct by organizations, many non-profit and for-profit organizations, especially those publicly held or having public stakeholders, have established corporate compliance programs modeled on guidelines

of the United States Sentencing Commission, as a precautionary measure in case an organization is found guilty of criminal felonies or certain misdemeanors under federal law. By definition, these programs are to be "designed, implemented, and enforced" to "detect" and "prevent"

Non-profit organizations, especially in health care and education, have led the trend toward independence, and their governing boards today are almost entirely made up of members who are independent of management. Publicly held companies have followed suit.

“criminal conduct.” Many organizations are re-examining these programs because their original implementation may have been as “prosecutorial” as the sentencing guidelines themselves, driving a wedge between these organizations’ governing boards and executives. As a result, these organizations are now returning their governing boards to their more traditional role of providing oversight and mentoring.

Expanding Business and Professional Representation in Place of “Community” Representation in the Composition of Non-profit Boards. One of the public relations strengths of non-profit boards is that their composition consists of “community” representatives. Yet, this is also a weakness because non-profit boards are not perceived by lenders and others as possessing the same “business” and “professional” expertise and experience as boards of for-profit organizations. As a result, non-profit organizations are expanding the business and professional representation in the composition of their boards. Accomplishing this, however, becomes complicated if compensation is necessary to attract business and professional representatives. Compensation will result in the loss of volunteer immunity under the federal and most states’ volunteer immunity statutes. To offset this loss, non-profits must re-examine the adequacy of D&O insurance as well as organization indemnity.

Focusing Attention by Downsizing Boards and Reducing Meetings. James Kristie of [Directors and Boards](#) reports that two of the most significant trends in the for-profit world have been the downsizing of boards and the number of their meetings. The reason for this economizing is to make boards more responsive to a fast-changing economy. Large companies like General Electric have downsized their boards to 15 members and high-tech companies like Microsoft and Yahoo have maintained smaller boards of seven and five members, respectively, in order to be responsive to a fast-changing, global economy. The average number of for-profit boards’ yearly meetings has decreased from 12 to fewer than eight. Non-profit organizations that have traditionally had boards with 30 or more members who meet on a monthly basis are rethinking the size and structure of their boards as well as the frequency and timing of their meetings.

Liability

Re-Examining the Adequacy of D&O Insurance. In order to attract and retain independent directors in today’s litigious society, organizations are reviewing D&O insurance products. D&O insurers are making more adequate products available. Riders for such additional coverage as employment practice

liability, fiduciary (including ERISA) liability, employee dishonesty, outside directorship liability, and punitive damage protection as well as endorsements for advancing defense expenses, change-in-control protection for post-transaction acts, and extension of coverage to claims of spouses are becoming more available to all organizations.

Loss Prevention Safeguards.

Non-profits have not customarily practiced the same loss prevention safeguards as have their for-profit brethren.

Recently, non-profits have exercised closer scrutiny over:

- Meeting notices and agendas;
- Discussion in and content of minutes and other corporate records;
- Practices of trustees or directors in taking notes; and
- Memoranda and other correspondence with members of the board and management regarding adverse claims.²

Two of the most significant trends in the for-profit world have been the downsizing of boards and the number of their meetings.

Disclosure and Reporting

Selective Disclosure. As a result of the recent media attention on selective disclosures by Compaq, Abercrombie & Fitch, and Webvan, the SEC proposed in December 1999 a new regulation, designated “FD” for full disclosure. The interesting aspect of this regulation and other newly proposed, related regulations is the view expressed by the SEC in its supporting reasons. The SEC’s stated premise in proposing Regulation FD is that it “does not believe that allowing issuers to disclose material information selectively to analysts is in the best interests of investors or the securities markets.” The SEC is apparently concerned because a National Investor Relations Institute study shows that 26 percent of responding companies engage in some type of selective disclosure practice. Believing that “information is the lifeblood of our securities markets,” the SEC states that “to the maximum extent practicable, all investors should have access to an issuer’s material disclosures at the same time.” In short, the proposed regulation requires that: (1) when an issuer intentionally discloses material information, it do so through public disclosure, not through selective disclosure; and (2) whenever an issuer learns that it has made a non-intentional material selective disclosure,

the issuer make prompt public disclosure of that information. What is significant about the proposed regulation is not the prohibition against selective disclosure, which is already prohibited by the anti-tipping line of cases under section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. The significance of the proposed regulation is

that the SEC is for the first time offering its view on what constitutes effective public disclosure. In so doing, the SEC begins to encroach upon an issuer's traditional freedom of choosing the forum, venue and audience for disclosures. Federal securities laws have never required issuers to disclose every material fact. Generally, the law does not require companies to make any disclosures to the SEC or any markets, or in releases of information to the media or to analysts, or in reports to security holders, in absence of:

- A report (such as a registration statement or periodic report on Form 10-K, 10-Q or 8-K) required to be filed with the SEC (or a securities exchange or quotation system) or proxy statement or other solicitation made of its security-holders; or
- A sale or purchase by the company of its securities to or from the public; or
- Knowledge or reasonable grounds to know by the company that persons controlling it (such as parent companies, directors, or officers), under common control with it (such as a brother or sister company) or controlled by it (such as its employees or agents) are selling or purchasing the company's securities.

The SEC apparently views the filing of Form 8-K as the most effective method of making a public disclosure. Under the proposed regulation, filing a Form 8-K is the required method. However, the SEC will "exempt" an issuer from the required Form 8-K filing if the issuer:

- Disseminates the information through a widely circulated news or wire service, or

- Makes an announcement at a press conference that is reasonably designed to provide broad public access which, according to the SEC, requires the issuer provide advance notice of the press conference to investors.

Again, what is interesting is the SEC's explanatory statement that "Dow Jones, Bloomberg, Business Wire, PR Newswire, or Reuters" each constitutes a widely circulated news or wire service. Also of interest is the SEC's explanatory statement that a press conference does not provide broad public access unless there is advance notice provided to investors. Apparently, the SEC does not view a waiting period necessary after filing, press release or press conference, recognizing that "revolutions in communications and information technologies have made it much easier for issuers today to disseminate important information broadly and swiftly."

Continued Attack on Insider Trading. The SEC is continuing its attack on insider trading. Reacting to several courts' refusal to find an insider trading violation in absence of a showing that there has been a related breach of a fiduciary or other relationship of trust and confidence, the SEC is proposing a new rule assuming the existence of such relationships. Proposed rule 10b5-2 assumes a duty whenever a person:

- Agrees to maintain information in confidence;
- Communicates the information to another person with the reasonable expectation, based upon a history, pattern, or practice of sharing confidences, that the other person would maintain its confidentiality; or
- Receives or obtains information from their spouse, parent, child, or sibling unless the person can demonstrate that the source of the information had no reasonable expectation that the person would keep the information confidential.

The SEC couples this rule with newly proposed rule 10b5-1. This rule prohibits any person, who is under any of the duties created by Rule 10b5-2 or any similar duty and who is in possession of material nonpublic information relating to an issuer, from refraining from making transactions in the securities of that issuer, except for a purchase or sale which was legally committed prior to that person's coming into possession of that material nonpublic information. From the supporting materials, we learn the SEC's view of the generally accepted definition of "materiality." According to the SEC, "materiality" is defined as information with which "there is a substantial

In governance, organizations are requiring more independence on boards, more focused oversight by boards, and further downsizing of boards and the number of their meetings in order to compete in today's fast-changing, competitive economy.

likelihood that a reasonable shareholder would consider it important" in making an investment decision, or if it would have "significantly altered the 'total mix' of information made available."

We also learn how the SEC would like issuers to deal with analysts. The SEC outlines several steps in handling analysts:

- "First . . . designate a limited number of persons who are authorized to make disclosures or field inquiries from analysts, investors, or the media."
- "Second . . . make sure that some record is kept of the substance of private communications with analysts or selected investors – for example, by having more than one person present during these contacts or by recording conversations."
- "Third . . . decline to answer questions that raise issues of materiality until they have had an opportunity to consult with others."
- "Fourth . . . secure the agreement of analysts not to make use of certain information for a limited time until they have had the opportunity to review their notes of the conversation and engage in whatever consultation they deem necessary to reach a conclusion as to materiality. . . ."

With these proposed rules, the SEC clearly defines what constitutes a breach of trust.

In the boardrooms and executive suites of American businesses, many trends are coming to the forefront.

Current trends in compensation include the use of nonqualified stock options, change-in-control compensation, and front-end planning to retain key executives. In governance, organizations are requiring more independence on boards, more focused oversight by boards, and further downsizing of boards and the number of their meetings in order to compete in today's fast-changing, competitive economy. Organizations are also following the trend of re-examining the adequacy of their D&O insurance and loss prevention safeguards in order to better protect themselves from liability in today's litigious society. Lastly, organizations are preparing for stricter disclosure and reporting guidelines which may come about through the SEC's newly proposed rules. Awareness of these trends will keep organizations competitive in today's ever-changing business climate and well-prepared for the challenges of the future.

¹ See "Incentive Compensation Is Available Through Nonqualified Stock Options," *Acredula*, December 1999, which further discusses the creative use of nonqualified stock options.

² See "Loss Prevention in the Board Room: Keeping the Blood off the Walls," *Acredula*, January 2000; and "Flunking the Duty of Care: The Four Most Common Mistakes Made by Directors" and "When It Comes to Corporate Minutes, Saying Less Is Often Better," *Acredula*, March 2000, which further discuss D&O insurance and loss prevention safeguards.

Counsel for BOARDS AND EXECUTIVES

A Bricker & Eckler Initiative

John P. Beavers, Chair
(614) 227-2361
jbeavers@bricker.com

Jerry O. Allen
(614) 227-8834
jallen@bricker.com

Laurie A. Briggs
(614) 227-2355
lbriggs@bricker.com

Thomas R. Brownlee, Jr.
(614) 227-2301
bbrownlee@bricker.com

John W. Cook, III
(614) 227-2383
jcook@bricker.com

Michael E. Flowers
(614) 227-2340
mflowers@bricker.com

James F. Flynn
(614) 227-8855
jflynn@bricker.com

Michael K. Gire
(614) 227-2318
mgire@bricker.com

Hope M. Goings
(614) 227-2360
hgoings@bricker.com

Steven R. Kerber
(614) 227-2356
skerber@bricker.com

Quintin F. Lindsmith
(614) 227-8802
qlindsmith@bricker.com

Gordon F. Litt
(614) 227-2305
glitt@bricker.com

Mark C. Pomeroy
(614) 227-2326
mpomeroy@bricker.com

Christine M. Poth
(614) 227-2395
cpoth@bricker.com

Richard D. Rogovin
(614) 227-2352
rrogovin@bricker.com

James A. Rutledge
(614) 227-8830
jrutledge@bricker.com

David C. Spialter
(614) 227-2342
dspialter@bricker.com

Michael F. Sullivan
(614) 227-2337
msullivan@bricker.com

Betsy A. Swift
(614) 227-8850
bswift@bricker.com

Kurtis A. Tunnell
(614) 227-8837
ktunnell@bricker.com

Faith M. Williams
(614) 227-2374
fwilliams@bricker.com

Randolph C. Wiseman
(614) 227-2310
rwiseman@bricker.com