ACC-SFBA Corporate & Securities Law Committee Meeting — "Say on Pay" and Other Dodd-Frank Requirements

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San Francisco Bay Area Chapter

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THE ACC-SFBA CORPORATE & SECURITIES LAW COMMITTEE

PRESENTS

"SAY ON PAY" AND OTHER DODD-FRANK REQUIREMENTS

JANUARY 19, 2011

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January 19, 2011

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SEC's Proposed Rules – Summary

- On October 18, 2010, the SEC proposed rules (the "Proposed Rules") to implement the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act relating to shareholder approval of executive compensation and "golden parachute" compensation arrangements.
- The Proposed Rules require reporting companies to:
  - conduct an advisory, non-binding shareholder vote to approve the compensation of named executive officers, e.g., a "Say on Pay Vote"
  - conduct an advisory, non-binding shareholder vote to determine whether to conduct a Say on Pay vote every one, two or three years, e.g., a "Say on Pay Frequency Vote"
  - provide additional disclosure of "golden parachute" compensation arrangements payable in connection with merger transactions, and to conduct an advisory, non-binding shareholder vote to approve such golden parachute arrangements, e.g., a "Golden Parachute Vote"
- The Say on Pay Vote, the Say on Pay Frequency Vote and the Golden Parachute Vote will be non-binding; but how a company uses the results of the first two votes must be disclosed.
- The initial Say on Pay Vote and Say on Pay Frequency Vote must be included in proxy statements relating to a company's first annual or other meeting of the shareholders occurring on or after January 21, 2011.

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Say on Pay Vote - Generally

- The Say on Pay Vote solicits approval of the compensation of a company's named executive officers ("NEOs"), including all executive compensation disclosure for such NEOs discussed and described in the Compensation Discussion and Analysis ("CD&A") as well as the compensation tables and other narrative executive compensation disclosures.
- The Say on Pay Vote must be to approve the compensation of NEOs, as disclosed in the proxy. A vote to approve a proposal on a different subject matter does not satisfy the Proposed Rules.
- Compensation policies and practices as they relate to risk management and risk-taking incentives would not be subject to the Say on Pay Vote as they relate to compensation for employees generally.
  - *Note:* To the extent that risk considerations are a material aspect of compensation policies or decisions for NEOs, the company is required to discuss them as part of its CD&A, and therefore they would be considered by shareholders when voting on executive compensation.
- The compensation of directors is not subject to the Say on Pay Vote.

Say on Pay Frequency Vote

- A company must conduct the Say on Pay Frequency Vote at least once every 6 years in proxy statements for annual meetings to determine whether such Say on Pay Vote will occur every 1, 2, or 3 years.
- Shareholders must be given four choices: whether the Say on Pay vote will occur every 1, 2, or 3 years, or to abstain from voting on the matter.
  - *Note*: Until final rules are issued, companies can give three choices and not include abstention as the fourth choice.

Say on Pay Vote and Shareholder Proposals

- The Proposed Rules permit the exclusion of any additional shareholder proposals that relate to say on pay voting, provided a company has adopted a policy on the frequency of its Say on Pay Votes that is consistent with the plurality of votes cast in its most recent Say on Pay Frequency Vote.

Disclosure of Results and Impact of Say on Pay Votes

- Companies are currently required to disclose the results of shareholder votes within four business days following the shareholder meeting. The Proposed Rules would not alter this requirement.
- The Proposed Rules require a company to disclose, in its next Form 10-Q or 10-K, as applicable, its decision regarding how frequently it will conduct its Say on Pay Vote.
- The Proposed Rules require a company to address in its CD&A whether and, if so, how its compensation policies and decisions have taken into account the results of past Say on Pay Votes.
  - *NOTE:* The SEC views this disclosure as in the nature of a mandatory principles-based topic that should not become boilerplate.

Broker Discretionary Voting Not Permitted

- For companies with a class of securities listed on a national securities exchange, broker discretionary voting of uninstructed shares would not be permitted for a Say on Pay Vote or a Say on Pay Frequency Vote.
  - We presume a similar requirement will apply to the Golden Parachute Vote.

Golden Parachute Vote

- Current rules require a *target* company seeking shareholder approval of a merger or other change of control-type transaction ("Merger Transaction Proxy") to disclose any agreements that the *target* company has with its NEOs concerning compensation that is based on or otherwise relates to the merger transaction.
- Current rules also require disclosure of any agreements that an *acquiring* company has with its NEOs and that it has with the NEOs of the target company, <u>but only</u> when the *acquiring* company is seeking shareholder approval.

Golden Parachute Vote – New Disclosures

- The Proposed Rules require disclosure of the golden parachute compensation to include the aggregate total of all such compensation that may (and the conditions upon which it may) be paid or become payable to or on behalf of NEOs.
- The Proposed Rules require additional new quantitative tables as well as new narrative analysis.

Golden Parachute Vote – Proposed New Disclosure Table

- The proposed table requires (1) quantitative disclosure of the individual elements of compensation that a NEO would receive in connection with the Merger Transaction Proxy and (2) the total for each NEO, including:
  - any cash severance payment (e.g., base salary, bonus, and pro-rata non-equity incentive plan compensation payments);
  - the dollar value of accelerated stock awards, in-the-money option awards for which vesting would be accelerated, and payments in cancellation of stock and option awards;
  - pension and nonqualified deferred compensation benefit enhancements;
  - perquisites and other personal benefits and health and welfare benefits; and tax reimbursements (e.g., 280G tax gross-ups); and
  - any other additional elements of compensation not specifically includable in the other columns of the table.
  - ***for each NEO, the aggregate total value of all the above compensation.***
- The proposed table also requires footnote identification of whether amounts attributable to "single-trigger" vs. "double-trigger" arrangements.

Golden Parachute Vote – Proposed New Narrative Description

- The Proposed Rules require companies to describe in narrative format any:
  - material conditions or obligations applicable to the receipt of payment, including but not limited to non-compete, non-solicitation, non-disparagement or confidentiality agreements;
  - their duration, and provisions regarding waiver or breach, including a description of the specific circumstances that would trigger payment;
  - whether the payments would or could be lump sum, or annual, and their duration, and by whom the payments would be provided; and
  - any other material factors regarding each agreement.

Golden Parachute Vote – Proposed Disclosure Agreements with Acquirer

- The Proposed Rules require disclosure of compensation pursuant to agreements between the *acquirer* and the NEOs of the *target* (even when not itself seeking shareholder approval).
  - *NOTE:* The Proposed Rules would not require a vote on agreements with the *acquirer*; they would require a Golden Parachute Vote only on the agreements between the *target* and its NEOs.
  - *NOTE:* The Proposed Rules would require the disclosure of *acquirer* agreements because the SEC believes that shareholders may find disclosure about these arrangements informative to their Golden Parachute Vote decisions.

Golden Parachute Vote Not Needed if Previously Included in Say on Pay Vote

- Companies would not be required to obtain a Golden Parachute Vote as part of a Merger Transaction Proxy if:
  - Disclosure of the golden parachute compensation has previously been included in the executive compensation disclosure that was subject to a prior Say on Pay Vote.
    - *NOTE:* The Proposed Rules require only that the golden parachute arrangements have been disclosed as part of a prior Say on Pay Vote; such arrangements need not have been separately approved by shareholders.
  - The golden parachute arrangements subject to a prior Say on Pay Vote must not have been modified subsequent to the prior Say on Pay Vote.
    - *NOTE:* New golden parachute arrangements, including any new equity grants on the same terms, and any modifications to golden parachute arrangements that were subject to a prior Say on Pay Vote would be subject to the Golden Parachute Vote with respect to only the new arrangements and revised terms of the arrangements previously subject to a Say on Pay Vote.
    - *NOTE:* The SEC has requested comments as to whether equity grants on the same terms, or new NEOs with a company's standard executive agreement, among other things, are "modifications" that would require a Golden Parachute Vote.

Golden Parachute Vote for New or Modified Golden Parachute Arrangements

- Under the Proposed Rules, companies providing for a Golden Parachute Vote on new arrangements or revised terms would provide two separate tables in their Merger Transaction Proxies.
  - One table would disclose all golden parachute compensation, including both arrangements and amounts previously disclosed and subject to a Say on Pay Vote and the new arrangements or revised terms.
  - The second table would disclose only the new arrangements or revised terms subject to the vote, so that shareholders can clearly see what is subject to the Golden Parachute Vote.
- Similarly, in cases where companies are required to disclose arrangements between an *acquiring* company and the NEOs of the *target* company, companies must indicate whether these agreements are included in the Golden Parachute Vote and provide separate tables of all agreements and understandings subject to the Golden Parachute Vote and all agreements and understandings with acquirer.

Impact on Non-Golden Parachute Severance Arrangements

- Companies will still be obligated to include in an annual meeting proxy statement disclosure about payments that may be made to NEO upon termination of employment.

Deadline for Golden Parachute Vote

- The Golden Parachute Vote and required disclosure will not be required for Merger Transaction Proxies until the final rules are issued and effective.
  - It is unclear how companies desiring to include a Golden Parachute Vote as part of its first Say on Pay Vote must satisfy this rule if final regulations have not yet been issued or become effective.

Things to Watch

- As noted above, there is significant controversy regarding whether golden parachute compensation approved in a Say on Pay Vote would also need to be subject to a Golden Parachute Vote in a Merger Transaction Proxy if non-golden parachute modifications were made, such as a new NEO hire or new equity grants, or even non-material amendments to prior agreements.
- It may well turn out that awarding a Golden Parachute Vote by including disclosure in a Say on Pay Vote creates an overly complicated golden parachute compensation disclosure and voting regime such that companies will opt to simply put all golden parachute compensation up to a Golden Parachute Vote in a Merger Transaction Proxy and not include the golden parachute tables and narrative disclosure in an annual proxy.
- Stay tuned…

Compensation Committee Independence

- SEC to direct stock exchanges to require listed companies' Compensation Committees to include only independent directors
- SEC rules to specify heightened independence determination, including consideration of:
  - Sources of director compensation (e.g., consulting, advisory or other fees company paid to the director); and
  - Whether the director is an affiliate of the company, a subsidiary or affiliate of a subsidiary
- SEC may exempt small issuers

Effective: SEC to issue rules within 360 days after enactment (July 2011)

Compensation Committee Advisers

- Company must provide funding and authority for Compensation Committee to obtain advice of independent compensation consultants, independent counsel and other advisers. Retention is at the discretion of Committee.
- In selecting advisers, Committee must consider factors identified by SEC that affect adviser independence, including:
  - Other services provided to the Company by adviser's employer;
  - Amount of fees received from the Company by adviser's employer as a percentage of its total revenue;
  - Conflict of interest policies of the adviser's employer;
  - Business or personal relationships between adviser and committee members; and
  - Company stock owned by adviser.
- Annual proxy statement must disclose whether the Compensation Committee engaged a compensation consultant, whether any conflicts of interest arose, and how any conflict was addressed.

Effective: SEC to issue rules within 360 days after enactment (July 2011)

Incentive Compensation Clawbacks

- SEC to direct stock exchanges to require listed companies to:
  - Disclose policy on incentive compensation that is based on reported financial information; and
  - Have a policy that, in the event of a financial restatement based on material noncompliance with financial reporting requirements, Company will recover from current or former executive officers any excess incentive compensation (including options) paid in the three years prior to the restatement that was based on the erroneous data

Effective: SEC to issue rules; no deadline specified

New Executive Compensation Disclosures

- Annual proxy statement
  - Clear description of S-K 402 executive compensation
  - Relationship between executive compensation actually paid and the financial performance of the Company
    - –Taking into account any change in the value of Company stock and dividends paid
    - –May include graph
- Executive compensation disclosure to include the ratio of CEO total compensation to median total compensation for all other employees

Effective: SEC to issue rules; no deadline specified

Employee and Director Hedging

- Company must disclose in its annual proxy statement whether any employee or director is permitted to purchase financial instruments that are designed to hedge or offset a decrease in market value of Company securities

Effective: SEC to issue rules; no deadline specified

Leadership Structure

- Company must disclose in annual proxy statement the reasons why the Company has chosen the same individual – or different individuals – to serve as chairman of the board and chief executive officer
- Similar to S-K Item 407(h)

Effective: SEC to issue rules within 180 days after enactment (January 2011)

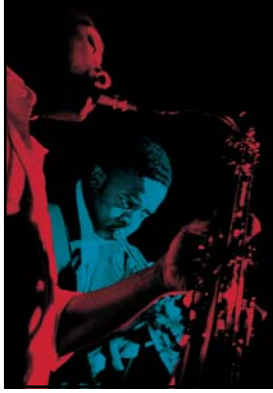
Proxy Access

- SEC specifically authorized to prescribe rules and regulations governing proxy access
- Rule-making authority
- Exemptive authority

Effective: Effective immediately; rule-making to come (likely for 2011 proxy season)

HOT TOPICS
COOL IDEAS

The Third Annual Aon Consulting
Client Symposium
September 20-22, 2010



New Day, New Rules:

Corporate Governance Reform and the Evolving Role of HR

Linda E. Amuso, President, Radford

Shareholder Environment: The Angry Investor

The World in Macroeconomic Crisis…	Yet Executive Compensation Practices are Slow to React
• Market volatility has disappointed investors, although many are "feeling better today" • Investors are frustrated by the lack of progress on improving executive pay practices • Companies have taken drastic measures to reduce costs and conserve cash • Uncertainty permeates the boardroom, employee base and public	• "Pay for failure" abounds in poorly linked incentive plans and severance arrangements • Executive compensation continues to increase, often in stark contrast to the treatment of employees and other value delivered to shareholders • Short-term thinking may induce executives to take unnecessary risks to maximize personal gain – Risky behavior at the top may create tolerances more broadly (e.g., off-label product selling, deal-cutting)

Executive Compensation Reform Has a Long History

1930s	1970s-1980s	1990s-2005	2010
Stock market loss - 86% (1930-32) (48% loss in Sept/Oct of 1929)		**Dot.com bust market loss - 38% (2000-02)**	**Financial industry crisis market loss - 54% (2008-09)**
• Creation of SEC (1934): Reporting Standards setting	• FASB created (1973) • Institutional Shareholder Services founded (1985) • 401(k) introduced (1978/1981) • 280(g) enacted (1984) as part of Deficit Reduction Act	• SEC granted authority to fine (1990) • Increased proxy disclosure requirements (1993) • 162(m) adopted (1993) • Sarbanes-Oxley (2002) • Stock option expensing (2005) • Increased proxy disclosure requirements/CD&A (2005) • Influence of proxy advisors grows (c.2000 -)	• Dodd-Frank (2010)

Each crisis involved a decline in shareholder returns and a call for action

Dodd-Frank Wall Street Reform and Consumer Protection Act

Say On Pay	▪ Companies will need to include two votes in 2011 with respect to say-on-pay – The first will be a say-on-pay vote, and the second will be a vote on the frequency of future say-on-pay ballots (1, 2 or 3 years) – Both votes are non-binding
Say on Golden Parachutes	▪ At the time of a transaction where shareholders are approving a deal, the organization will be required to include a vote on change-in-control compensation paid to named executives
Enhanced Disclosure	▪ Graphical reporting of actual named executive officer pay alongside company financial performance ▪ Disclosure of the median annual compensation of employees and of the CEO (and the ratio of the two) ▪ Explanation for Board structure (e.g., role of CEO, Chair Lead Director) and the justification for this structure ▪ Detailed disclosure of hedging policies

Dodd-Frank Wall Street Reform and Consumer Protection Act

Clawback Pay	▪ Companies must implement and disclose policies for recouping incentive pay (cash and equity) based on material non-compliance with financial reporting rules – Policy will require a three-year look back (from the date restatement is required) ▪ Applies to all current and former executive officers, not just CEO/CFO as currently covered under SOX
Committee Independence	▪ New exchange listing standards governing the source of committee member compensation or fees, including fees provided for consulting/advisory services, as well as director affiliation with any subsidiary or affiliate ▪ Compensation Committee solely responsible for advisor selection, taking into consideration the factors the SEC will identify as defining independence ▪ Enhanced disclosure detailing advisor selection, any conflicts of interest and how those conflicts have been addressed ▪ Funding must be provided to the Board to secure its own compensation committee advisors
Broker Voting	▪ Broker-dealers to be prohibited from voting shares on executive pay and director elections without instructions from the owner ▪ The SEC to define where these restrictions apply

Institutional Shareholders are More Vocal

- ISS and Glass Lewis are industry-leading shareholder service providers
- Self-styled voice of investors, they base voting recommendations on proprietary analyses
  - Influence has grown substantially in past decade
- Methodologies assess a company's performance and commitment to governance in various areas:
  - Governance practices and structure
  - Risks
  - Pay practices
  - Social responsibility

Institutional Shareholders: Areas of Poor Pay Practices

Issue	Poor Pay Practices
#1	Pay-for-failure "involuntary severance" arrangement
#2	Change-in-control – single trigger payments, gross-up tax provisions and trigger definitions
#3	Pay-for-performance disconnects (payout levels and timing)
#4	Discretionary incentive plan designs (lack of clear metrics to align pay and performance)
#5	Peer group design (process and aspirational companies)
#6	Performance/goal setting and risk management
#7	Perquisites (of any type)
#8	Hedging and underwater stock option exchange programs (without shareholder approval)
#9	Evergreen employment contracts
#10	Excessive dilution

Responding to the New World of Executive Compensation

Issue	Old World	New World
Compensation Philosophies	All elements of pay above median to attract, retain, and motivate	Salaries at median (or below); incentives at or above median based on performance, equity, or at or above median
Peer Group Development	Peers are elected based on industry with limited focus on company size	Separate peer groups for executive-size specific, broad employee and sales – segment specific
Cash Incentives		
Measures	Often one - revenue or profit	Multiple - growth and efficiency
Leverage	3:1 or higher, uncapped	Capped at 150%-200% of target
Thresholds	75%	Creeping up - 80% or more
MBOs	Commonly 20% of target	Eliminated at the executive level
Discretion	Regularly applied to adjust for uncertainty; typically upward	Applied downward by the Board

Responding to the New World of Executive Compensation

Issue	Old World	New World
Long-Term Incentives		
Vehicle	Stock options	Mixed; time-based restricted stock has grown, but performance shares are the future
Performance Metrics	N/A	Performance metrics incorporated versus peers or market, not just plan
Commitment to Ownership	Broad-based to drive alignment	Targeted to drive shareholder returns
Ownership Guidelines		
Prevalence	"That's for old-line companies"	Common practice across all company sizes and industries
Form	1x-4x compensation	Retention guidelines, target values increase 2x-6x
Participation	Board, CEO/CFO (SOX compliance)	Board, Officers and expanding to former officers

Responding to the New World of Executive Compensation

Issue	Old World	New World
Change of Control		
Triggers	Single triggers	Double trigger
Level	2x for executives, 3x for CEO	1x for executives, 2x for CEO
Gross up	Full gross up	Best net benefit
Clawbacks		
Prevalence	Non-existent	Best practice, especially in light of risk rules
Term	1 year	3-year look back
Trigger	Fraud	Accounting restatements
Coverage	Annual cash bonus Trigger based on an executive committing "fraud" CEO and CFO (SOX)	Cash bonus, equity compensation and any other awards linked to company performance that would otherwise not been earned All officers, current and former

Roles Must Evolve to Respond to the New Reality

- Drive communication to shareholders, proxy advisors and staff
- Proactive process management

- Work directly with Compensation Committee
- Participate in executive sessions
- Challenge the status quo and historic market practices

- Lead succession planning
- Balance risk, return and rewards for long-term success

- Drive cross-functional relationships
- Provide education on regulatory changes impacting governance, compensation committee
- Implement best practices in working with the Compensation Committee

Transparency is paramount

Improve Process Management with the Compensation Committee

Assist Compensation Committee Chair and Human Resources in developing Compensation Committee calendar

Key Actions and Decisions	Feb-March	May	Sept	Dec	Feb	March	May	Advisor
Review and approve FY plans including company and individual goals for executive team, incentive plan structure, equity pool and guidelines	x							Provide input on management proposals for alignment with governance trends and best practices
Review executive compensation comparator groups and philosophy		x	x					Identify criteria and companies and recommend changes
Review CEO and preliminary executive compensation assessment and next fiscal year design considerations including merit increase budget				x				Complete CEO and Executive committee assessment Review CEO analysis for educational purposes
Review executive tally sheets as part of executive compensation changes				x	x			Work with HR to prepare materials for Committee to review
Review prior period performance and determine bonus pool and individual payments for CEO and executive officers	x					x		Provide guidance as needed for Committee discussions
Determine and approve pay of CEO and executive team	x					x		Provide independent review of recommendations for Committee discussion
Review and recommend to board any pay plan changes for directors (every 2 years)					x			Complete assessment and recommend changes for inclusion in proxy
Review executive officer succession plan and/ or performance						x	x	No action unless executive retention analysis performed
Review market trends that can impact next year plan		x		x			x	Provide market trends and changes in governance and best practices for committee consideration

Illustrative Example

Better Understanding of Compensation Risk

Program	Plan Eligibility	Performance Measurement	Limits (Min/Max)	Measurement Period	Approved By
Incentive Plan at Management Level	Senior executive team	Pipeline/ development milestones EPS, revenues	200%	Annual	Compensation Committee
Incentive Plan for Broader Group Below Management	Non-sales employees below senior executive level	20% corporate 80% individual	150%	Annual	Individual managers
Incentive Plan for Salespersons	Global sales force	Product revenue Team and individual goals	Uncapped Quarterly review of outliers	Annual	Individual managers
Performance-Based Stock Incentive Plan	VPs+	EPS, net income, revenue	150% maximum opportunity 50% threshold	Three-year	Compensation Committee

Illustrative Examples

- Risk review has focused on ***plan features*** but there are other areas of risk
- Sales compensation disconnects include quota and commission crediting and revenue recognition
- Approval process and controls, eligibility and award criteria, all impact risk of legal action for discriminatory treatment

Take-Away

- The world of executive compensation has changed
  - Historical benchmarking will no longer serve as the only best practices platform
- Re-thinking compensation requires a willingness by all participants to accept and manage change
- Plan design should fit your business first and foremost
  - No competitive advantage in following exactly what others do
- HR has the opportunity to have a greater voice in linking business strategy, best practices and rewards
  - Compensation Committee support becomes more strategic
  - Determining where to lead, pace or follow can be an advantage
- HR must become a voice for all shareholders
  - Creating more transparency between external and internal shareholder


For More Information
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HOT TOPICS COOL IDEAS
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Corporate and Securities Alert:

"Say on Pay" Rules Proposed

OCTOBER 28, 2010

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Summary

The SEC has released a rule proposal ("Proposal") designed to implement provisions of the Dodd-Frank Act relating to shareholder approval of executive compensation and golden parachute compensation arrangements. We believe the final rules will closely track the Proposal, so issuers preparing proxy statements now should draft with the Proposal in mind. Proxy statements for meetings on or after January 21, 2011 are affected.

The Dodd-Frank Act requires all public companies to:

- Conduct a shareholder advisory vote to approve the compensation of named executive officers – a "Say on Pay Vote" – at least once every three years;
- Conduct a shareholder advisory vote to determine whether the Say on Pay Vote should be taken every 1, 2 or 3 years – a "Say on Pay Frequency Vote" – at least once every six years; and,
- Conduct a shareholder advisory vote to approve named executive officer compensation arrangements in connection with an acquisition transaction – a "Golden Parachute Vote" – unless those arrangements were previously subject to a Say on Pay Vote.

These shareholder votes are advisory only – the results are not binding on the company or its board of directors. However, the Proposal includes requirements that the company disclose whether (and how) it has considered results of past Say on Pay Votes and Golden Parachute Votes, and how frequently it will hold Say on Pay Votes in the future.

What compensation does the Say on Pay Vote cover?

Shareholders will be asked to approve the compensation of the company's named executive officers ("NEOs") as described in the Compensation Discussion and Analysis ("CD&A"), the compensation tables and other narrative disclosure of executive compensation. The vote must relate to all of the company's required executive compensation disclosures, so narrower votes, such as a vote to approve the company's CD&A or compensation philosophy, will not satisfy the requirement.

The company's analysis of any risks associated with its general compensation programs – which is generally outside of the executive compensation disclosure – would not be covered by the Say on Pay Vote. However, if incentive structuring and risk management considerations are a material aspect of NEO compensation that a company wishes to address, it should do so in the CD&A, which would then be disclosure considered in connection with the Say on Pay Vote.

With the advent of Say on Pay Votes, the primary purpose of executive compensation disclosure – particularly the CD&A – shifts from disclosure compliance to shareholder information and persuasion. It is still important that executive compensation disclosure be accurate and complete, but now it is also important that it be responsive to shareholder interests, and clearly and convincingly present the company's thinking behind its executive compensation policies and decisions.

What is the Say on Pay Frequency Vote?

The Say on Pay Frequency Vote allows shareholders to vote on whether the Say on Pay Vote should in their view occur every 1, 2, or 3 years. The Say on Pay Frequency Vote must be conducted no less frequently than once every six years.

The Proposal requires that shareholders must be given four choices for a Say on Pay Vote: every year, every other year or every third year, or to abstain from voting on the matter. Until final rules are issued, companies may omit the abstention – if no choice is selected by a shareholder, the proxy will not be voted.

When do proxy statements first have to include a Say on Pay Vote and a Say on Pay Frequency Vote?

The initial Say on Pay Vote and Say on Pay Frequency Vote must be included in proxy statements for annual or other meetings of shareholders occurring on or after January 21, 2011. This is the case whether or not the SEC has adopted final rules to implement these provisions of the Dodd-Frank Act. Proxy statements for annual meetings of companies with fiscal years ending on September 30, 2010 will likely be the first proxy statements to include this material.

What disclosures are required in connection with the Say on Pay and Say on Pay Frequency Votes?

The Proposal requires that a company report in its CD&A whether the company has taken into account the results of previous Say on Pay Votes when making its compensation policies and decisions — and, if so, how. In the first year, this disclosure might be prospective only; it is not clear whether

in future years the staff will expect commentary only on the most recent Say on Pay Vote, or something broader.

The Proposal also requires the company to disclose (in its next Form 10-Q or Form 10-K, as applicable) its decision about how frequently it will conduct future Say on Pay Votes. Because it is advisory, the company can choose to follow the shareholder vote or not, but would be well advised to explain its reasons for selecting a frequency other than that preferred by the largest number of shareholders.

The Form 8-K requirement that companies disclose results of shareholder voting within four business days following the day the shareholder meeting ends were not changed by the Proposal, so it applies to these votes.

Are we required to file a preliminary proxy statement because we include a Say on Pay Vote or a Say on Pay Frequency Vote?

No.

Can shareholders still submit proposals that seek a shareholder vote on executive pay or that relate to the frequency of shareholder votes on executive pay?

Yes, but companies would be permitted to exclude shareholder proposals on these matters if they were already substantially implemented. Specifically, such proposals may be excluded if the company has adopted a policy on frequency of Say on Pay Votes that is consistent with the plurality of votes cast in the most recent Say on Pay Frequency Vote.

When is a Golden Parachute Vote required?

The Proposal requires that public companies make new disclosures in connection with proxy or consent solicitations relating to change of control transactions. This would include any acquisition, merger, or proposed sale of all or substantially all of a company's assets, including going-private transactions and third-party tender offers. Required disclosures relate to all written or unwritten agreements or understandings that the target company and the acquiring company have with the NEOs of each company, if those agreements or understandings are based on or related to the change of control transaction.

Target company compensation arrangements with its NEOs that are related to an acquisition would be disclosed in the target company proxy statement that solicits shareholder approval of the acquisition and would be subject to a Golden Parachute Vote. Acquisition-related compensation under arrangements between the acquiring company and target company NEOs would need to be disclosed in the target company proxy statement, but no shareholder vote would be required with respect to those arrangements. If the acquiring company solicits approval of the transaction by its own shareholders, it would disclose transaction-related compensation for its NEOs, and a Golden Parachute Vote with respect to those arrangements would be required.

The new disclosure would include tabular and narrative material. In the table, the following compensatory elements must be separately quantified and totaled:

- Cash severance payments (salary, bonus, cash incentive plan, etc.)
- Dollar value of accelerated equity awards and payments in cancellation of equity awards (calculated based on the issuer's stock price as of the latest practicable date)
- Dollar value of pension and nonqualified deferred compensation benefit enhancement
- Health & welfare benefits, perquisites (even if *de minimis*) and other personal benefits
- Tax reimbursements (e.g., 280G gross-ups)

This material must be presented in tabular format (payments under "single-trigger" and "double-trigger" arrangements must be separately identifiable – such as through footnote references).

The required narrative disclosure would describe material conditions and obligations to any present, deferred or contingent compensation. Triggering events must be described and all material factors regarding each arrangement will be required to be disclosed. Payment schedules must be discussed and the party making the payments must be identified. No exception is made for arrangements that do not discriminate in favor of executives and that are generally available to all employees, or for *de minimis* perquisites and other personal benefits. The Proposal does not require disclosure of payments attributable to amounts that are vested regardless of the change of control transaction, nor does it require disclosure of any bona-fide compensation payable pursuant to any post-transaction employment agreement.

Is there any way to avoid a Golden Parachute Vote?

The Proposal includes rules implementing the Dodd-Frank Act exemption from the Golden Parachute Vote requirement if the arrangements have already been subject to a prior Say on Pay Vote. However, if the golden parachute arrangements that were previously disclosed and voted upon have been modified or expanded (including by virtue of a new award), new disclosure and a new Golden Parachute Vote would be required.

Are we required to use any particular form of language for any of the three shareholder advisory votes?

No.

Is broker discretionary voting on a Say on Pay or a Say on Pay Frequency Vote permitted?

No, and broker discretionary is already prohibited in connection with merger or acquisition transactions.

Are smaller reporting companies exempted from these rules?

No.

Action Items?

Say on Pay is here, and companies that have meetings in late January or early February will not have much guidance available because the rules will be new and sample disclosures will be few. However, companies should clearly consider these issues:

- Think through how often you want to hold a Say on Pay Vote, and support a management recommendation with explanations that shareholders will find persuasive.
- Concentrate on making your CD&A more readable and more informative about why executive compensation is structured as it is and how the company's executive compensation was determined, with the objective of persuading shareholders to understand and support the Compensation Committee's executive compensation decisions and policies.
- Defer any effort to take advantage of the Golden Parachute Vote exception until the SEC's rule-making on this aspect of the Proposal is final, and more companies have experimented with different approaches. For most companies it is unlikely at this point that adding golden parachute disclosure as part of a Say on Pay Vote will be sufficient to avoid a future Golden Parachute Vote in the event of a subsequent change of control transaction.

For more information on these or related matters, please contact Scott Spector or Horace Nash.
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SEC Rule-making Calendar for Select Dodd-Frank Act Provisions

October – December, 2010	January – March, 2011	April – July, 2011
Exempt Offerings		
§413: **Propose** rules to revise the "accredited investor" standard **[Done]**		§413: **Adopt** rules to revise the "accredited investor" standard
§926: **Propose** rules disqualifying the offer or sale of securities in certain exempt offerings by certain felons and others similarly situated **[Done]**		§926: **Adopt** rules disqualifying the offer or sale of securities in certain exempt offerings by certain felons and others similarly situated
Corporate Governance & Disclosure		
§951: **Propose** rules regarding shareholder votes on executive compensation, golden parachutes ("Say on Pay") **[Done]**	§951: **Adopt** rules regarding shareholder votes on executive compensation, golden parachutes ("Say on Pay")	
§951: **Propose** rules regarding disclosure by investment advisers of votes on executive compensation **[Done]**	§951: **Adopt** rules regarding disclosure by investment advisers of votes on executive compensation	
	§952: **Propose** exchange listing standards regarding compensation committee independence and factors affecting compensation adviser independence; propose disclosure rules regarding compensation consultant conflicts	§952: **Adopt** exchange listing standards regarding compensation committee independence and factors affecting compensation adviser independence; adopt disclosure rules regarding compensation consultant conflicts
§1502: **Propose** rules regarding disclosure related to "conflict minerals" **[Done]**		§1502: **Adopt** rules regarding disclosure related to "conflict minerals"
§1503: **Propose** rules regarding disclosure of mine safety information **[Done]**	§1503: **Adopt** rules regarding disclosure of mine safety information	
§1504: **Propose** rules regarding disclosure by resource extraction issuers **[Done]**		§1504: **Adopt** rules regarding disclosure by resource extraction issuers

October – December, 2010	January – March, 2011	April – July, 2011
		§§953 and 955: **Propose** rules regarding disclosure of pay-for-performance, pay ratios, and hedging by employees and directors
		§954: **Propose** rules regarding recovery of executive compensation ("Clawbacks")
		§957: **Propose** rules defining "other significant matters" for purposes of exchange standards regarding broker voting of uninstructed shares

RADFORD ALERT

THE POST-REFORM WORLD: WHAT COMPENSATION COMMITTEES CAN DO NOW TO PREPARE FOR 2011

New laws create need for comprehensive executive compensation and governance review

By Edward J. Speidel, Ted Buyniski and Ram Kumar

With the passage of some of the most sweeping financial reform legislation since the Great Depression – in the form of the Dodd-Frank bill – the rules surrounding executive compensation and governance have become more pervasive and concrete. While some of the specifics of implementation are to be determined by the SEC later in the year, it is clear that boards will want to think through how these new rules affect their executive compensation strategies and other governance-related issues now. It is critical to remember that while the impetus of the bill was to address specific practices in the financial service industry, the governance aspects of the bill apply to *all* public companies, not just financial services.

This paper focuses on the key areas of executive compensation and governance touched by the legislation, and what Compensation Committees must do to prepare for the 2011 proxy season. (A table of the executive compensation reforms created by Dodd-Frank is included at the end of this article).

Say on Pay

At least in terms of visibility, the say-on-pay provision of Dodd-Frank has perhaps the most far-reaching consequences in terms of the process changes and reexamination it will likely set into motion in public boardrooms. Beginning in 2011, all public companies must allow shareholders a non-binding advisory vote on executive pay. The only notable twist in the legislation is that it seeks shareholder input on how frequently these votes are held after 2011 (they can be annual, biannual or every three years). The say-on-pay vote is advisory only.

Different companies and different Compensation Committees will have different perspectives on how frequently they want shareholders to voice their opinions.

On the one hand, the three-year shareholder advisory cycle more closely aligns with the notion that pay and performance are better understood and evaluated over a longer period of time than a one-year period. Some companies will argue that the longer advisory cycle will help executives focus on producing results sustained over the longer term. But other companies might well look to annual voting to foster a good working relationship with shareholders, and ensure they are able to establish the trust that would be required to implement any potentially

controversial practices later. The technology and life sciences companies that already have implemented say-on-pay (e.g., Motorola, HP, Pfizer, Intel) have largely favored the two- or three-year models.

The actual impact of the legislation on company behavior is unclear at this time. Looking at experience in the United Kingdom, the effect has been to moderate some of the more high-profile disconnections between pay and performance.

Radford Perspective*: Compensation Committees should begin preparing for say-on-pay by focusing on three aspects of their compensation programs. First, is the absolute level of compensation reasonable? While the vote ideally reflects the totality of the program, most commentators agree that foremost in the view of shareholders will be the* amount *of pay. Second, is there a demonstrable link between pay and performance? To the extent that executive pay does not vary with performance – especially remaining stable or growing when the company performance lags – there is a greater likelihood of a negative reaction from shareholders. Finally, are there elements of the pay package that are likely to draw negative attention – gross ups to change-of-control agreements, outlier perquisites, etc.? To the extent that these three areas create issues, Committees should be looking to modify their programs now, rather than after a "no" vote.*

Clawbacks

Dodd-Frank has widened the existing SOX regulation concerning clawbacks by expanding the list of employees covered to any current or former executive officer. The new law includes a three-year look back period (from the time a restatement is required), and will apply to any restatement triggered by a material lack of compliance with reporting rules, not just when there is a case of fraud. The SEC will be working on how to define specific requirements for the policy and its disclosure. Some of the open questions include how to deal with taxes paid on any pay recovered after a restatement, and how to deal with situations where incentive pay was not tied to a specific metric.

Radford Perspective: *More guidance is required from the SEC in order to understand the full implication of the new law; however, the Compensation Committee will likely work closely with the Audit Committee on this issue.*

Change-of-control-related Payments

The new law addresses pay received by executives related to a merger/acquisition by allowing shareholders to vote separately on that pay at the same time as they are given a vote on the transaction.

Radford Perspective: *This is an area where Compensation Committees can be proactive well before any transaction. For a number of years, the institutional investor community has focused on eliminating "egregious" contract provisions, such as 280G "Golden Parachute" gross-ups, and single triggers on severance and equity. To avoid creating any issues at the time of a transaction, companies should aggressively begin to move their change-of-control and employment contracts to a more shareholder-friendly basis – replacing gross-ups with best net benefit provisions and eliminating single triggers from their agreements and plans.*

Reviewing Compensation

Other notable aspects of Dodd-Frank include disclosure of executive pay compared to company performance, and disclosure related to pay ratios (or internal pay disparity). In terms of their impact on the need for boards to begin evaluating their executive pay strategies, all of these are related, and all ultimately go to the concern of ensuring that strategies are defensible to shareholders, as well as proxy advisors and other important stakeholders.

Therefore, the passage of these provisions suggests Compensation Committees begin considering a variety of steps, including a review of their executive compensation strategy and philosophy, as well as their shareholder communication strategy.

While Dodd-Frank creates a more constrictive environment for Compensation Committees, it also creates an opportunity for companies to revisit their compensation philosophies and the strategies that flow from those philosophies. In reviewing executive pay, committees should consider the following areas in light of the new regulations:

> *Target pay positioning and pay mix:* As mentioned above, the specific regulations governing how pay-for-performance will be disclosed are yet to be determined; likely the SEC will release those regulations later in the summer or fall. However, we know enough at this time to understand that targeting compensation above the median will attract a new level of scrutiny by shareholders, so, for example, pay set at above the median will need to be supported by performance targets above median. Companies will also need to ensure that their CD&As explain how the specific pay mix and the proportion of total pay "at risk" have been determined, and how they contribute to the company's overall pay-for-performance strategy.

> But Compensation Committees will also have to balance these issues with the need to ensure that in an effort to comply with the law, they don't leave their companies exposed to the risk of losing key senior employees to labor competitors. The point is not to avoid above median pay targets, but rather to ensure that the performance return on that pay is clearly reported.

> *Peer groups*: Current peer groups should be assessed to determine how well they match the company in terms of market/labor competition, size, industry, and risk profile. Once determined, companies should consider disclosing the selection criteria (including actual revenue, headcount, market cap, etc. data) for each peer, along with a rationale to answer any potential shareholder and proxy advisor concern about "cherry picking" peers.

> *Long-term incentives and metrics*: Compensation Committees will want to review their long-term incentive plans and the metrics that are used to set payouts against industry practice, their own corporate objectives and those of their primary talent competitors. Metrics should be evaluated relative to their ability to drive shareholder value, be impacted by direct management action, and be measureable.

> *Relative pay levels*: If say-on-pay is likely to have the most far-reaching impact on companies, the new requirement to report relative pay levels is likely to be the most cumbersome. Dodd-Frank requires the reporting of median annual total compensation for all employees and the ratio of that to the CEO's annual total compensation. The SEC will need to decide exactly what will be included in the calculation of total pay, but one reading of the legislation raises the prospect of having to calculate all pay elements (benefits, pensions, perquisites, equity) for all employees, in addition to factoring in currency exchange calculations. Irrespective of how pay is calculated, the numbers are likely to be inflammatory, given the absolute difference between the lowest and highest paid and the pace of increase in that difference over the past decade or two. In years to come, we may well see companies examining and reporting on how the level of disparity at their company compares with market and labor competitors.

> *Proxy disclosure practices*: In light of the numerous pay- and governance-related reforms and policy changes in the past six or so months, companies will want to do a thorough review of their disclosure practices for 2011. The SEC has strongly signaled its intention to hold companies to a high standard of disclosure, and that is likely to intensify as it seeks to ensure companies are complying with the spirit and letter of the new laws. Additionally, because companies will now be compelled to hold a say-on-pay vote in 2011, the CD&A will be the primary mode of communication between companies and their shareholders, and the primary marketing tool used to "sell" their executive compensation strategies.

> *Compensation consultant independence*: Dodd-Frank made clear that the selection of a compensation consultant is the purview of the Compensation Committee, and has called for additional disclosure of both the selection and the degree of independence of the consultant. It did not change how the SEC had defined "independence" for compensation consultants for 2010; it reinforced that the determination of independence would be left up to Compensation Committees and shareholders (as outlined by the SEC). But the new law does suggest that companies will want to thoroughly disclose how the Compensation Committee determined that no conflict exists.

> *Board composition/Compensation Committee member independence*: Prior to Dodd-Frank, companies were required to disclose why the CEO and Chair positions were held by the same person; now companies must disclose why the roles are split when that is the case. The new law also now requires that Compensation Committees be composed solely of independent directors.

One other significant component of Dodd-Frank is the limits it places on broker voting in director elections, say-on-pay votes, and potentially other matters. Under the new law, broker/dealers will no longer be allowed to vote shares without instructions from their beneficial owners. This represents a meaningful departure from historical practice, in which brokers voted their shares under management, commonly resulting in 90%+ votes for directors. With beneficial owners chiming in more directly on director votes, it would not be unreasonable to expect far lower percentages of “For” votes. And in cases where companies have adopted majority voting, this could result in many more directors facing the threat of being voted off the board.

With this new voting rule (combined with the other provisions in the Dodd-Frank) we are likely to begin seeing a different tone and frequency of communications between boards and shareholders. The extent to which evolving communication requirements influence changes in the executive compensation plan strategies under discussion remains to be seen.

Appendix A
Dodd-Frank At-A-Glance

Dodd-Frank Provision	Details
Say-on-pay	• Companies will need to include two votes in 2011. The first will be a say-on-pay vote, and the second will be a vote on the frequency of future say-on-pay ballots (one, two or three years). The vote on the frequency of say-on-pay ballots will need to be held every six years. o Goes into effect six months after President's signature
Say on change-in-control compensation	• Companies will need to provide a separate vote on change-in-control compensation paid to named executives, if those arrangements were not previously voted upon, at the time of a transaction. o In effect for any meeting to approve change-of-control transaction that occurs six months after President's signature.
Pay-for-performance	• Requires graphic reporting of actual named executive officer paid alongside company financial performance. o The SEC will determine how both pay and company performance will be quantified for reporting purposes; there is no deadline for issuing its determination.
Pay ratios	• Companies must disclose in the proxy the median annual compensation of employees and of the CEO (and the ratio of the two). o The SEC will have rule on how compensation is defined in this context; there is no deadline for issuing its determination.
Compensation committee independence	• Companies must comply with exchange listing standards governing the source of committee member compensation or fees, including that provided for consulting/advisory services, as well as director affiliation with any subsidiary or affiliate of the company. o Rules to take effect within a year.
Compensation consultant independence	• Companies must provide boards with the funding necessary to secure their own compensation advisor. • Compensation Committee must be solely responsible for advisor selection, taking into consideration the factors SEC will identify as defining independence. (Advisors will not need to be independent.) • Disclosure must be made detailing the advisor selected, any conflicts of interest and how those conflicts have been addressed. o Rules governing advisory independence are to be issued within a year.
"Clawback" policies	• Companies must implement and disclose policies for recouping incentive pay based on material non-compliance with financial reporting rules. Policies will need to apply a three-year look back (from the date restatement is required). Applies to all current and former executive officers, not just CEO/CFO. o There is no deadline for the SEC to issue these rules.
CEO/Chair role rationale disclosure	• Companies must explain why CEO and Chair roles are held by the same, or different, persons. o SEC must issue these orders six months after signage of the bill.
Hedging	• Disclosure will be required detailing the hedging policies of the company. o There is no deadline for the SEC to issue the rules defining disclosure.
Broker Voting	• Broker-dealers to be prohibited from voting shares on executive pay and director elections without instructions from the owner. o The SEC will be allowed to expand this to other voting situations as it deems fit.

More Information

We encourage you to forward this document to your board members. And as always, we encourage you to contact us if you have questions. For more information, contact:

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About Radford

For more than 35 years, Radford has provided compensation market intelligence to the technology and life sciences industries. Global survey databases, which include 3.6 million incumbents, offer current, reliable data to nearly 2,000+ clients. Leveraging Radford survey data, our thought-leading global Radford Consulting team creates tailored solutions for the toughest global business and compensation challenges facing companies at all stages of development. In addition to our consulting team, we also offer equity valuation assistance via Radford Valuation Services, and leading-edge market analyses and survey services with Radford Analytic Services. Radford's suite of surveys includes the Global Technology, Life Sciences, and Sales Surveys, as well as the US Benefits Survey. For more information on Radford, please visit http://www.radford.com/.

About Aon Consulting

Aon Consulting is among the top global human capital consulting firms, with more than 6,300 professionals in 229 offices worldwide. The firm works with organizations to improve business performance and shape the workplace of the future through employee benefits, talent management and rewards strategies and solutions. Aon Consulting was named the best employee benefit consulting firm by the readers of Business Insurance magazine in 2006, 2007, 2008 and 2009. For more information on Aon Consulting, please visit http://www.aon.com/human-capital-consulting.

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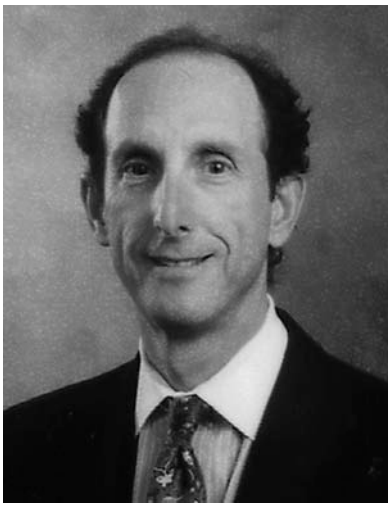
David A. Bell is a partner in the Corporate Group of Fenwick & West LLP, a law firm specializing in technology and life sciences matters. Mr. Bell practices out of the firm's Mountain View, California, office. His practice includes incorporation of and advising start-up companies, venture capital financings, intellectual property licensing, mergers and acquisitions and initial public offerings as well as counseling public companies in securities laws compliance matters and periodic reporting to the SEC.

Mr. Bell represents a wide range of high technology companies, from privately held start-ups to publicly traded corporations. Among the clients he has represented are:

- ArcSight, Inc.
- Chegg, Inc.
- Coupons.com Incorporated
- Covad Communications Group, Inc.
- Glu Mobile Inc.
- Kony Solutions, Inc.
- MetricStream, Inc.
- Solergy, Inc.
- Tropos Networks, Inc.
- Virgin America Inc.

Mr. Bell served as interim Chief Compliance Officer of InVision Technologies, Inc. during the course of its recent Foreign Corrupt Practices Act investigation and initial integration into GE.

Prior to law school, Mr. Bell was a systems manager for a mid-sized company based in Silicon Valley. He received his undergraduate education at the University at Buffalo, SUNY, graduating with a Bachelor of Science degree in business administration in 1990. Mr. Bell attended the Graduate School of Management at the University at Buffalo, SUNY, where he received his Master of Business Administration degree with certificates in corporate financial management and management information systems in 1991. He attended law school at the University of California at Davis where he served as symposium editor of the *Journal of International Law & Policy,* graduating *Order of the Coif* with a Juris Doctor degree in 1997. He is a member of the National Honor Society of *Phi Kappa Phi* and is admitted to the State Bar of California.



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Scott P. Spector chairs the executive compensation and employee benefits group of Fenwick & West LLP. His practice emphasizes the compensation issues that arise in connection with mergers and acquisitions, and corporate governance matters involving executive compensation. He also specializes in serving high technology and software clients in designing and implementing executive compensation, equity compensation and other employee benefit arrangements. He is an expert on Section 409A and 280G matters. Mr. Spector also represents numerous chief executive officers of technology companies in contract negotiations. Among his current and previous clients are:

- Agilent
- Barclays Global Investors
- Cisco Systems
- Intuit
- Symantec Corporation
- Synopsys
- Virgin America

He is the former Chair of the Subcommittee on Executive Compensation of the Federal Regulation of Securities Committee of the ABA Business Law Section and the Subcommittee on the Federal Securities Regulation of the Committee on Employee Benefits of the ABA. Mr. Spector is a member of the Practising Law Institute Board of Advisors and co-chairs the ALI/ABA annual program on executive compensation. He is a frequent speaker at national compensation, governance, and securities law programs, and has written extensively on executive compensation, corporate governance and stock compensation matters. He was named to *The Best Lawyers in America 2011* in the area of Employee Benefits Law and recognized by *Chambers USA* as one of the top Employee Benefits and Executive Compensation lawyers in California.

Mr. Spector received his Juris Doctor from Tulane University in 1974 and his Masters in Law (in Taxation) from New York University in 1975. He is a member of the California, New York and Illinois bars and numerous bar associations.

Linda E. Amuso, Radford — President

Linda is a highly recognized thought-leader and an expert in the field of executive and employee compensation design for the technology and life sciences industries. For 20 years, Linda has worked directly with senior management and Board of Directors on developing and implementing executive and equity compensation strategies, effectively linking performance management strategies to salary systems, and designing annual/long-term incentive plans. Since joining Radford in 2005, Linda has been instrumental in building Radford's consulting practice and expanding Radford's services globally.

In 1993, Linda co-founded iQuantic, Inc. (acquired by Buck Consultants in 2001), and was a key contributor in building the organization into a national compensation consulting business. She also led the expansion of iQuantic's business into the life sciences industry, offering consulting and survey support. At Buck Consultants, Linda held a number of leadership positions including Western Region Compensation Practice Leader, National Leader for the Biotechnology Sector and Northern California Market Leader.

Linda earned a bachelor of science from Ithaca College and a master of arts in industrial and labor relations from Cornell University. She speaks on compensation and corporate governance issues frequently, and has been quoted in national business press, including the Wall Street Journal. Linda is based in San Francisco.

Notes: