LOS ANGELES BUSINESS JOURNAL®

July 14, 2003

Reform Measures Yield Mixed Results

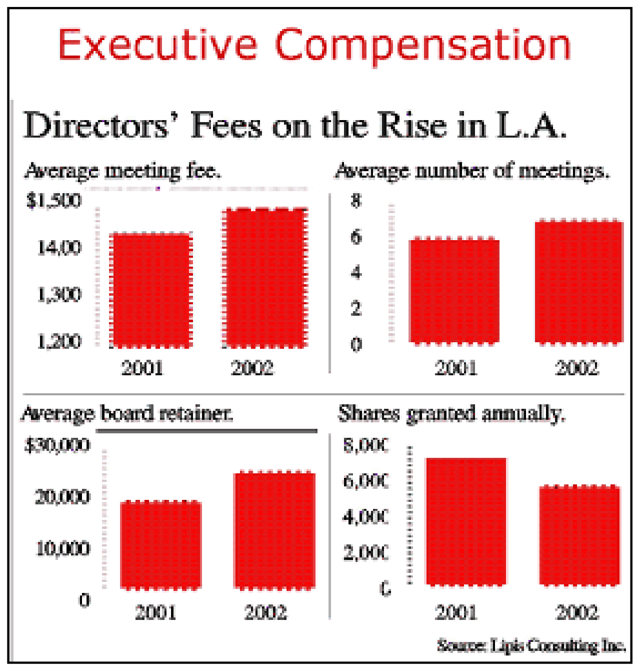
Board Shuffle Raises Cost, Time Demands

By KATE BERRY
Staff Reporter

Corporate boards in Los Angeles are undergoing major changes as companies haltingly strengthen oversight of their top executives, a new report has found.

In response to new rules mandating stricter corporate governance measures, companies are hiring more outside directors, at a higher cost, according to data compiled from Securities and Exchange Commission filings by L.A.-based **Lipis Consulting Inc.**

Board retainers at 88 of the largest L.A. companies rose an average of 32 percent, to $25,029 in 2002, the study found. As board members take on higher workloads and increased liability in the wake of Sarbanes-Oxley legislation, board pay is expected to rise another 9 percent this year.



"It will take more money for companies to get the kind of people they want," said the firm's president, Mark Lipis.

To comply with the new regulations, companies such as Los Angeles-based Equity Marketing Inc. are shuffling their boardrooms, extending the hours and content of board meetings and increasing the number of independent directors.

Moreover, directors willing to sit in hot seats - heading audit or compensation committees - are getting a boost in retainer fees.

Equity Marketing's chief financial officer, Larry Madden, can attest to the changes.

Pay increases of 30 percent or more are expected as directors take on more responsibility, he said. Meetings now last nine hours, up from four hours a year ago.

The company created a new governance committee to oversee compliance with Sarbanes-

Oxley. In addition, the departure of two board members, including the brother of Chief Executive Donald Kurz, allowed the company to add one additional independent director. (The company's preferred equity investor took the other open seat.)

"We looked long and hard about how we wanted to reshuffle the board and independence is certainly an important issue," Madden said. "We also wanted to have a very seasoned finance and accounting director."

Audit talent

To that end, the company hired Howard Bland, a former partner at accounting firm KPMG, who will head the audit committee.

Like other companies, Equity Marketing is taking a hard look at how it compensates directors, who have been paid $20,000 in cash per year and typically receive 10,000 shares a year of restricted stock.

Unlike stock options, restricted stock has become more popular as a compensation alternative for directors because it is expensed under current accounting rules.

The company also is creating a new compensation structure - which is sometimes called special duty board pay - that rewards those directors that provide the most time and service. Committee chairs also will receive higher compensation.

"It's a lot more difficult to be a director today than it was even two years ago," Madden said. "We felt it was fair to create a structure that rewards those willing to invest the time."

Because Los Angeles has mostly small- and mid-sized companies, directors' compensation tends to be lower here than in cities with Fortune 1,000 firms. (A survey released in February by Pearl Meyer & Partners, a New York consulting firm, found that directors of 200 big New York companies received average salaries of $152,000 a year in 2001.)

Many investors are surprised by the high level of compensation for directors who typically meet just a handful of times a year.

"Many people think that if a director is getting $1,000 a meeting, it's a lot of money," Lipis said. "But lawyers and accountants charge $2,500 a day and now there's so much additional exposure and liability."

Because the report looked at pay programs that went into effect in 2002, Lipis expects even bigger changes over the next two years.

Among the report's findings:

- Real estate, entertainment and communication companies paid the highest retainers to board members at $35,000 a year or more, while retailers and utilities paid the lowest, at $15,000 a year.

- The average number of outside board members has risen to 6.3 in 2002 from 5.7 in 2001.

- Audit committee chairmen ($6,000) and compensation committee chairmen ($4,000) receive the highest supplemental retainers.

- Despite a push by shareholders and institutional investors to increase payments to directors in stock, the use of stock in pay programs is decreasing.

- The number of shares granted upon election to a board has increased slightly to 15,473, but it is expected to fall dramatically in the next few years. In addition, annual stock grants fell 27 percent in 2002.

- Some companies have formed new governance or compliance committees.

- Fees for attending committee meetings increased for companies of all sizes.

Slouching toward reform

While there are many changes in the works, they appear to be driven mainly by mandates, rather than companies' determination that the changes are needed.

When asked to categorize issues by importance, 85 percent of company respondents cited legislative changes and 69 percent suggested regulatory changes were issues of the highest priority.

Board compensation issues were cited by 54 percent of respondents as important, while 39 percent were concerned about board performance.

Just 30 percent of respondents surveyed said attracting and retaining board members was one of the highest priorities.

Alfred Osborne, senior associate dean of the Anderson School at UCLA and an expert on corporate governance, said a sea change is underway that will require greater corporate accountability, more transparency and more independent boards.

"The independent board is being asked to be more active and more skeptical," said Osborne, who sits on the boards of Equity Marketing, Nordstrom Inc. and K2 Inc.

Though boards, by and large, are reactive and work slowly, Osborne said he believes the Sarbanes-Oxley legislation will force management to become proactive in bringing problems to boards, and that will make companies more accountable.

"A corporate culture has to support a commitment to better governance and different points of view," he said.

Osborne lauded several firms such as Corporate Library, a governance research firm, and Institutional Shareholder Services Inc., a leading proxy advice firm, that have received attention for rating companies on corporate governance issues.

Both ratings firms have singled out the board of Burbank-based Walt Disney Co. for being too friendly with Chairman and Chief Executive Michael Eisner.

"When companies are performing well, they can get away with less attention paid to proper governance," Osborne said. "But when you're not performing well and shareholder value is being seriously eroded, then investors are concerned and rightfully so."