

# the Corporate Governance I a d v i s o r

ASPEN PUBLISHERS

November/December 2009 • Volume 17, Number 6

---

---

## EXECUTIVE COMPENSATION

---

### Director Pay Trends Reflect Current Economic Conditions

*By Theresa Tovar, Robert Newbury and  
Ted Jarvis*

Company executives and employees are not the only ones feeling the pay ramifications of the economic crisis. Decisions on pay for nonexecutive directors have clearly been influenced by the crisis as well. A new Towers Perrin analysis of director pay practices shows that major companies are taking a “wait and see” stance for the most part, avoiding drastic changes to their director pay programs in an environment where salaries for many employees and executives have been frozen or reduced, retirement benefits have been curtailed and incentive programs have delivered below-average payouts. However, several companies that were strongly affected by the financial upheaval made changes to their director pay packages in response to difficult economic conditions. In short, it’s clear that the constraints and concerns that challenged companies in terms of executive pay seeped over to the director side as well.

Our latest annual review of director compensation at *Fortune* 500 companies reveals that overall total remuneration for directors increased in the most recent year, although at a much lower rate than in the preceding years.<sup>1</sup> While pay programs

*Continued on page 2*

---

© 2009 Towers Perrin. Theresa Tovar, Robert Newbury and Ted Jarvis are with Towers Perrin.

---

---

## CONTENTS

---

---

### EXECUTIVE COMPENSATION

---

- Director Pay Trends Reflect Current Economic Conditions** 1  
By Theresa Tovar, Robert Newbury and Ted Jarvis
- Changes in Change-in-Control Practices** 9  
By DJ Shetty

---

### RISK MANAGEMENT

---

- Boards of Directors and Risk Committees** 16  
By E. William Bates, II and Robert J. Leclerc

---

### SOCIAL MEDIA

---

- Twitter: Analysis of Corporate Reporting Using Social Media** 19  
By Darrell Heaps

---

### MANAGEMENT OF LEGAL REVIEWS

---

- Sweating the Small Stuff: Creating Quality Everyday Contracts** 24  
By Theodore E. Guth

---

### PROXY ACCESS

---

- Shareholder Proxy Access: Still Relevant for 2010 Annual Meetings?** 28  
By Robert K. Morris

## Sweating the Small Stuff: Creating Quality Everyday Contracts

By Theodore E. Guth

*“Small miseries, like small debts, hit us in so many places, and meet us at so many turns and corners, that what they want in weight, they make up in number, and render it less hazardous to stand the fire of one cannon ball, than a volley composed of such a shower of bullets.”*

—Charles C. Colton, Lacon

*“A billion here, a billion there, and pretty soon you’re talking real money.”*

—attributed to Senator Evert Dirksen

Most businesses—even if reluctantly—routinely involve lawyers in “major” contracts and transactions such as mergers and stock sales. On the other hand, “everyday” matters such as purchase orders, leases, customer and vendor agreements, equipment purchase contracts and other common transactions generally slip below the legal radar screen, even when more aggregate dollars are involved over time.

Lawyers just seem to cost too much, and not just in terms of money: getting a contract reviewed by a lawyer, even in-house counsel, can take too much time, yield impractical advice and grind business to a standstill. Lawyers can seem too eager to say “no”: it’s hard for them to make a mistake when nothing happens. Unfortunately, that also makes it impossible for you to be successful: business is about making opportunities and taking smart chances, while managing the risks.

Lawyers sometimes seem more focused on legal technicalities than on understandable advice: over the last fifty years, the size of the average legal document has doubled or tripled, often with little apparent benefit for business. Legal review often produces a document that only a lawyer could love—thus insuring that the other party will involve their lawyer, further slowing down the process and

costing even more money. It sometimes seems that if everyone simply avoided using lawyers, no one would need lawyers. In the words of Nancy Reagan, “Just Say No.”

As a result, it’s easy to turn to self help: find a document that seems close (even one provided by the other side) and mark it up yourself. While this involves some risk that the contract won’t comply with applicable law or could prove difficult to enforce in court, business people suspect, often correctly, that business contracts rarely violate law and rarely become the subject of litigation. But good legal review has benefits even in the absence of litigation: a document that clearly and concisely sets forth both parties’ expectations can prevent making deals that should never be made, help the parties understand their responsibilities so the relationship goes smoothly and set a framework and expectations for resolving problems that develop.

In many cases, a properly drafted agreement can actually avoid disputes. Unfortunately, because of the lack of legal review, many everyday forms used by businesses are incomplete and inconsistent. Indeed, especially when dealing with transactions outside their core area of expertise, many businesses don’t even think through the business model. Even worse, many of them use bad legalese, either because the drafter starts with a legalistic form or mimics what he or she thinks a lawyer would do.

### Controlling Costs

Enjoying the benefits of legal review requires controlling the costs—in money, time and disruption. Unless you can develop a form that can be reviewed once and reused in many transactions, you can’t afford to spend \$25,000 to review a \$25,000 contract. Good legal review has to take into account the economic realities: you may be able to justify \$1 million to fix a one percent problem on a \$100 million deal, but the same problem is only worth \$1,000 in a \$100,000 deal.

Unfortunately, many common approaches to controlling legal fees don’t work very well. Using

---

*Theodore E. Guth is a Partner of Manatt, Phelps & Phillips, LLP and the Chair of Manatt Business Select, an innovative client-centered approach to practical and creative business legal services with a transparent cost structure.*

---

very junior lawyers often costs more, not less, as the additional time required by their inexperience more than offsets their lower rate per hour. At least as important, the value of the review suffers: if anything, everyday contracts often require more judgment (to know what is cost effective to worry about) and experience (to understand the business model). Similarly, letting the other side hire the lawyer to draft the contract may also not save money, as reviewing and marking up a draft can often be more expensive than drafting one. In addition, if the agreement is poorly done or unreasonable, you face the dilemma of how to fix it without being offensive. Finally, you are almost guaranteed an agreement that is worse for you, even after negotiation.

These problems lead some business people to negotiate the deal, draft the contract and only then consult a lawyer “if necessary” to review a few specified provisions. If you adopt this approach, you lose a key benefit of involving a lawyer: clarifying the business deal and identifying points you have not considered. Life is not arbitrarily compartmentalized into “legal” and “business” issues, particularly in many everyday contracts, where the issues are often less familiar to both lawyers and business people.

### **Adopting a Cooperative Model**

In fact, the best approach to cost effective legal review is exactly opposite: use a cooperative approach, with both you and your lawyer focused on the big picture from the beginning:

- Start by hiring an experienced lawyer who shares your business philosophy and who you can trust to deliver on time and on budget—or will call first to discuss the reasons for any expected overruns. Make sure that your lawyer won’t unnecessarily involve other lawyers, and won’t spend time researching esoteric issues. While not easy, getting the right lawyer and building the right relationship makes all the difference.
- Before anyone puts pencil to paper, spend a little time just talking through the business model and the major pitfalls with your lawyer. In many cases, an hour talking with the right lawyer at the beginning can add immense value, by including a fresh eye, experienced in disciplined analysis,

to help formulate your negotiation approach and the deal structure. Equally important, you can’t expect your lawyer to understand what’s important if you haven’t discussed your business rationale.

- At the end of the discussion, you can determine who should negotiate the deal and draft the documents. Divide the responsibilities based on the importance and complexity of the deal and your own experience and expertise. If you or the other side drafts the agreement, have your lawyer give the whole contract a quick read through (again, this should not take much time.) Don’t start by just asking for a mark-up unless you know your lawyer understands the issues; first discuss the results, identify the problem areas, get a budget for further work, and then decide which issues are worth the cost of fixing them.

### **Drafting Thoughtfully**

Whether you draft the contract or have your lawyer do it, it needs to be done well. Drafting everyday contracts can actually be more demanding: the margin for error is smaller, the business issues sometimes less familiar, the readers less sophisticated. Often the business model is more complicated, not less, than in “complex” transactions such as the sale of stock or assets; the available forms are almost always worse. Some suggestions:

- *Start by understanding your business model.* Start by walking through the transaction from start to finish, stopping at each point to think about what the possible problems and appropriate consequences. Be realistic; since you probably won’t get everything you want, be ready to make the almost inevitable tradeoffs. At the same time, consider the transaction from the other party’s point of view: what do they want? What are they worried about? Except in the simplest of cases, the next step is a summary of the business terms, rather than a contract; it’s cheaper to draft and negotiate, the other side is less likely to get a lawyer involved and you can focus on key points without the distractions of additional legal terms.
- *Tell a story.* It has been popular to call humans the “tool making animal,” but we may really be the “story animal.” We insist on making

---

everything a story (even inkblots). When you start drafting, don't insert clauses in a random order. Instead, create a narrative, telling the story of the transaction or relationship as you developed it in your summary. This helps you, by requiring you to understand the transaction; it helps the deal, by ensuring common expectations; and it even helps in litigation, by helping a judge or jury understand the situation and the contract as you want them to see it. If your story isn't clear, someone else will make one up.

- *Recognize your document is a negotiation.* Use your contract to advocate your position, giving it the same attention and thought as any other negotiating approach (maybe more, since a contract, like a bad email, stays around). Think about how you can make your draft acceptable to the other side (since that's the goal). If you add a clause where the purpose is not clear, or that could sound unreasonable, add some language to explain the purpose and reason, and to relate it to the story. Since negotiation is as much emotional as it is rational, start with the benefits of the contract to the other side to get the other side's head nodding and keep it nodding. If the other side objects to a provision on first reading, they will often hang on to their objection even once you explain it.
- *Tailor your document to your audience.* Because documents are negotiations, what you say and how you say it depends on your audience. Everyday contracts are generally directed at non-lawyers; if the language of your document makes them uncomfortable, they are more likely to refer it to a lawyer or resist the point, slowing down or even derailing the deal. Keep the language simple, especially in the provisions defining the business deal. Avoid legalese, for example, use the names of the parties rather than generic defined terms; avoid "thereunders", "aforesaid" and the like; change "such" to "this" or "that." Even legal terms that are physically shorter—like "hereof" instead of "of this Agreement"—take longer to process for people who don't use those terms everyday.
- *Keep the tone reasonable.* Unless you are a major bank, you generally can't afford to be capricious or overreaching; indeed, starting that way may lose points if it doesn't kill the deal altogether. Even if you have the leverage to force the other

side to sign a one sided deal, the long term costs to the ongoing relationship can be substantial, so be sure the business value of the point is worth that risk. Even when (maybe especially when) the substance of your document is aggressive, keep its tone reasonable. For example, reciprocal clauses seem inherently reasonable, even when the practical benefits strongly favor one side (for example, a mutual indemnity where one party is simply paying money and thus has little or no exposure).

- *Choose the format of your document.* The format you choose can affect the reaction to your document. For most everyday contract purposes, keep the document short: even if you have to change the font size or margins, a one page document is better than two pages, and two better than three. If you are not creating a formal document, don't start with definitions; most people read a document with anxiety until they find the key points they expect, and then relax and pay less attention. Make their key points easy to find: consider putting the business deal in the first page or two and then use an appendix for the legal terms (think purchase order with term and conditions).
- *Consult multiple forms.* Most people start with an old document and then rely on it as a crutch to outline the business deal. In everyday contracts, however, there is less likely to be an easy "form" to use, leaving the need to adapt—or misuse—an existing form for another. In general, it is best to draft from your summary of the business terms, then look at multiple forms to check your work, using clauses from each that match that portion of the current deal.

In the end, none of these rules can be applied blindly; to quote Wendell Johnson, "[a]lways and never are two words you should always remember never to use." For example, if it fits the expectations of the other side, it may actually help to be legalistic. The key is to make conscious choices in drafting.

## Following Through

Drafting everyday contracts should not only start with a dialogue with your lawyer; it should end on the same note. Business people negotiate

---

most everyday contracts, often with little follow-on review by the lawyers. (In fact, that's the whole point of developing form contracts). However, to make this work, finishing the draft is only the start. You need to:

- *Understand the form.* You must understand the purpose of each clause, how it relates to your business model, the likely potential alternatives and when you will need to consult with your lawyer. If the negotiations are to be handled by lower level employees, this is even more important.
- *Focus on the language.* Make sure that the person negotiating the contract has the patience and

inclination to actually read and consider any changes proposed by the other side.

- *Keep your forms secure.* When you create a form document, make sure you start from the original form each time, not from the last document you negotiated. Save your form in a place where it won't get overwritten by new versions.

Creating effective everyday agreements on a cost effective basis is not easy. However, by choosing and managing a cooperative relationship with the right lawyer, starting with your business model, drafting consciously and following through, you can create better everyday contracts without breaking the bank.