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Compensation Considerations for Director Service on Special Committees

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PRINCIPAL

The role of a board director in any publicly traded company is inherently demanding, involving oversight of complex and critical issues that ensure the company's longevity and success. The formation of special committees to address specific, often temporary, issues is a common duty among these responsibilities. These special committees are established in addition to typical standing committees like the audit, compensation, and nominating/governance committees, and they often require significant additional time and effort from their members, necessitating a careful examination of appropriate compensation levels. There are several issues to consider when allotting compensation for special committee service, including the need for fairness, a recognition of the committee's workload, and alignment with market practices.

Understanding Special Committees

Special committees are formed to tackle specific tasks that fall outside the purview of standing committees. These tasks often include mergers and acquisitions (M&A), internal investigations, strategy realignment, litigation support, a CEO search, and other high-stakes matters that demand focused attention and expertise. These temporary committees are set up to address situations where existing board structures are insufficient to manage the workload, or where a potential conflict of interest might be present, such as a CEO-led management buyout.

Rationalizing Compensation for Special Committees

The additional workload and intensity of tasks handled by special committees can sometimes justify separate compensation structures. Directors who agree to join such a committee are already compensated for their regular board service and then expected to commit extra hours, delve into intricate details, and make decisions that could significantly impact the company.

Compensation for service on a special committee tends to vary based on the complexity and duration of the subject event or purpose, the time requirement, and number of meetings held, and it also varies by the level of responsibility (e.g., chair vs. member). One common decision point for providing this additional pay is whether the time required of members is equivalent to or greater than the time requirements of their normal-course board and standing committee service. Based on an examination of survey data reported over the course of the last five years, when members on special committees receive compensation, it is generally in line with that of the regular standing committees.

The rationale for compensating directors for their work on special committees includes several key points:

- **Time and Effort**: Special committee assignments involve extensive review of financials, legal documents, and operational data, often requiring more time than regular board duties.
- **Importance of Work**: The decisions made by special committees can often make or break the future of the company.
- **Fairness**: Recognize that taking on significant additional responsibilities should come with additional compensation.
- **Attracting and Retaining Talent**: The best directors are in high demand, and fair compensation is crucial to keep them engaged and motivated.

Companies considering compensation for director service on special committees should also take into account the potential impact of major US stock exchange rules regarding consulting fees paid to board members and how that pay might affect their independence. Notably, there are heightened standards of independence for service on the audit and compensation committees. Additionally, proxy advisory firms will recommend a vote "Against" a director who is not independent under their criteria if the director sits on the audit, compensation, or nominating committees or would cause the board to consist of less than a majority of independent directors.

Approaches to Special Committee Compensation

There are several approaches to determining fair compensation for special committee service. These include linking pay to existing standing committee fees, paying monthly or per-meeting fees, and calculating fees based on an estimated hourly rate.

Approach 1: Fees Relative to Other Standing Committees
This approach involves setting special committee fees comparable to those of existing standing committees. Special committee cash retainers are often similar to annual audit or compensation committee cash retainers, regardless of the committee's duration.

Approach 2: Monthly and/or Per-Meeting Fees
This approach, although less common in recent years, ties compensation directly to the effort and time commitment involved. It includes a monthly fee and/or per-meeting fee, with a suggested cap to prevent "excessive" compensation. In one recent situation where a company established a special committee to oversee a corporate reorganization, a compensation structure was established under which the committee members received a $25,000 annual retainer, the chair received an additional $5,000 annual premium above the retainer, and each member, including the chair, received additional per-meeting fees of $2,500 per meeting.

Approach 3: Fees Based on an Estimated Hourly Rate
This method involves calculating compensation based on an estimated hourly rate, multiplied by the anticipated additional hours required. For instance, a company recently estimated that an hourly rate of $850 was appropriate for additional service related to oversight leading up to a significant merger, which resulted in additional monthly fees. However, the recommendation was to cap these fees to avoid surpassing annual board service compensation, thereby maintaining fairness and avoiding negative perceptions from stakeholders.

Market Practices and Recommendations

Market practices reveal a range of compensation models for special committee service. Pearl Meyer's research found that while not all companies provide additional compensation for special committee service, those that do typically offer cash retainers, and do not provide additional equity grants. The median annual cash retainer for special committee members is around $20,000, with chairs receiving a premium, bringing their total to approximately $25,000.

Best Practices

Ultimately, fair compensation for special committee service motivates directors to bring their best efforts to the table, benefiting the company and its shareholders. The compensation models should be transparent, justifiable, and aligned with market practices to avoid negative scrutiny and legal challenges. A balanced approach combining retainers and/or per-meeting fees, with caps to prevent excessive payments, is an effective strategy. By carefully considering and implementing reasonable compensation levels, companies can ensure that their special committees are well equipped to handle the complex and high-stakes issues they are formed to address.

About the Author

Peter Wertheimer is a vice president at Pearl Meyer. In this role, he provides executive compensation and governance advisory services to boards and management teams across industries. Much of Peter's vast experience is in the tax-exempt healthcare space, but he has worked with non-profit as well as privately held and public for-profit organizations of all shapes and sizes. He specializes in executive pay benchmarking, incentive plan design, peer group development, nonqualified retirement plan design, and board compensation, among other areas.

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