Minutes of Compensation Committee Meetings

American University Board of Trustees

September 8, 2004

The Compensation Committee met in New York City, at the offices of Towers Perrin, George Collins presiding. Leslie Bains was present; Pete Smith participated by phone; Gary Cohn was unable to attend. Richard Meischeid of Towers Perrin was also there.

Richard reviewed the implications of the Intermediate Sanctions and presented Towers Perrin's survey report comparing AU executive compensation to the special comparison group that AU had been using in previous years. This group is comprised of universities that are generally larger than AU, but representative of the universities with which we compete for students and leaders.

AU's compensation policy has been to target executive compensation at the 75th percentile of the survey comparison group for similar positions. The Towers Perrin survey data showed that for most positions, AU is paying well above this target – in fact, above the 90th percentile for a number of positions.

This is a very different result from the comparative data we had been receiving from PricewaterhouseCoopers. The primary reason for this is that the PWC data had included only base salary and annual incentive bonus, not counting the deferred incentive element that Dr. Ladner and all of his cabinet members receive. Looking at annual cash compensation alone, the numbers from the two consultants are generally comparable.

Mr. Meischeid also shared verbally the results of Towers Perrin's proprietary study of 30 leading colleges and universities, including all the Ivies. This group is clearly a tier above American University and its primary comparison group, yet in many cases AU executives are compensated well above the 50th percentile of this premier group, and in some cases above the 75th percentile.

The Committee discussed this problem, noting that it was important to get a comfort letter from Towers Perrin or another independent source on the level of compensation for Dr. Ladner and his direct reports. Mr. Meischeid reported that we would be unlikely to get such a letter at AU's current compensation levels.

Mr. Smith reported that although Dr. Ladner and Don Meyers had both indicated that comfort letters had been secured in past years, no such letters had been requested from PricewaterhouseCoopers or any other firm and none had been received.

The meeting then focused on Dr. Ladner's compensation package. Dr. Ladner had given Mr. Collins a memorandum requesting a substantial increase in his compensation over the next three to five years. Included in this request was a large cash payment to make up for an underperforming split dollar insurance contract, an increased retention incentive similar to the $500,000 special incentive the Board had granted Dr. Ladner five years ago, and a one-time performance bonus recognizing his ten years of service to AU.

It was clear to the Committee that none of these additional payments would survive the Intermediate Sanctions test of reasonableness, and in fact that we needed to reduce Dr. Ladner's compensation going forward.

With salary, annual bonus, deferred incentive, and retention bonus, Dr. Ladner's effective annual compensation was currently in the $850,000 range. Mr. Meischeid suggested that a more reasonable package going forward would be a salary of $550,000 with a 20% deferred incentive (and no annual incentive) or a salary of $600,000 with a 10% annual incentive. These levels could be considered reasonable in comparison to the Towers survey of the top 30 colleges and universities, although there was some question as to whether the use of the very largest and best colleges would be deemed reasonable.

The Committee also discussed this significant impact this would have on Dr. Ladner and his cabinet, and stressed the need for thoughtful communications on this issue.

November 4, 2004

The Committee met in Washington, at American University, prior to the November Board meeting. In attendance were Mr. Collins, Ms. Bains, Mr. Smith, Mr. Cohn (by phone), Dr. Ladner, and Richard Meischeid of Towers Perrin.

At Mr. Collins request, Mr. Smith outlined the issues that had been discussed at the September Compensation Committee meeting, noting the importance of the Intermediate Sanctions and the Board's concern about receiving a comfort letter. Mr. Smith also reported that past documentation supporting the use of the special AU survey comparison group made it difficult to justify using any other group, such as Towers Perrin's top 30 survey, to support AU compensation levels. This put somewhat tighter constraints on Dr. Ladner's compensation than we had considered in the September meeting.

All the Committee members emphasized that the situation did not reflect any dissatisfaction with Dr. Ladner's performance or that of his cabinet, which the Board thinks has been outstanding. The problem is the Intermediate Sanctions and the practical limits they impose, a factor that had not received sufficient consideration in the past.

After reviewing the survey report and the recommendations the Committee intended to make to the Board (eliminating the annual incentive going forward, adjusting base pay upward to the degree possible, encouraging Dr. Ladner to join one or two outside Boards, possibly making a substantial charitable contribution in his name), the Committee dismissed Mr. Meischeid and asked for Dr. Ladner's reaction.

Dr. Ladner had prepared a letter for Mr. Collins in which he questioned the accuracy of the compensation survey and the qualifications of Mr. Meischeid. Based on his significant expertise in executive compensation, Mr. Smith strongly objected to both assertions and suggested that Dr. Ladner, Mr. Meischeid and a Committee member meet to work out any differences and reach agreement on the process going forward. This meeting was scheduled for November 15, 2004. Ms. Bains agreed to represent the Committee at this meeting.

Dr. Ladner also expressed great dissatisfaction with the communications process surrounding his compensation.

The Committee then explored possible ways to keep pay reasonable while lessening the negative impact on Dr. Ladner. These included the possibility of employing Dr. Ladner's wife on behalf of the University, paying 100% of Dr. Ladner's long-term disability insurance (a common practice, while AU pays only 50%), and encouraging Dr. Ladner to do more outside speaking for fees.

Dr. Ladner also raised the possibility of his being appointed Chancellor of the University, with reduced administrative responsibilities but continuing significant compensation. The Committee did not discuss this alternative in any detail, nor was the subject raised at the Board meeting the following day.