Gaming's Board Rooms — from *IDEALS* to *BEST PRACTICES*

BY KEITH KEFGEN AND JULIETTE BOONE

The economic crisis has also caused a crisis in the board room. The scrutiny leveled at directors has never been more acute as shareholders ask tough questions about company strategy, executive pay, risk management and governance transparency.

The U.S. Congress has even proposed numerous regulations that would establish more stringent corporate governance rules. Many of the new proposals are consistent with standards we have been advocating for years.

How has the gaming industry fared with corporate governance during the downturn?

Our 12th annual study of best practices in the board room indicates that the average governance score decreased slightly, by one point, from 28 to 27, over last year. However, gains have been made in certain areas. For example, fewer insiders are sitting on gaming boards, and a number have appointed a lead director. Furthermore, director and executive compensation appear to be better aligned with shareholder goals, according to our ratings.

Our conclusions are based on analysis of the documents of 35 publicly traded gaming companies (slightly fewer than last year's 38 companies). As is our practice we also conferred with other corporate governance experts to rate each company in the following four fundamentals:

- Size, makeup and independence of the board
- Committee structure and effectiveness
- The presence of insider participation and related transactions
- Fundamental commitment to executive pay-for-performance.

For each of these categories we have identified specific attributes or activities and award 0-10 points accordingly.

Our intent is to see past boilerplate language in proxy statements to determine who is serving shareholders most effectively. Our goal is to take the perspective of a well-informed investor and try to understand what is going on behind board room doors.

SIZE, MAKEUP, INDEPENDENCE

Governance experts agree that a successful board ideally should be composed of five to 11 members (an odd number in case of tie votes) and have less than 25 percent insiders, maximizing independence and objectivity. In 2009, 62 percent of gaming boards fell into this size range versus 52 percent in 2008.

The presence of an outside chairman is the hallmark of a truly independent board, and 19 out of 35 companies had a non-CEO as chairman. Of the 19 chairmen who were not the CEO, 10 were independent outsiders. In 2009, eight companies named a lead director, another positive step in controlling the power of a CEO/chairman.

Length of term was our final consideration in this category, with a one-year term viewed as optimal. Fifteen companies still had staggered terms of more than one year.

COMMITTEE STRUCTURE

Governance experts deem the following committees as mandatory: audit, compensation, nominating and governance. In evaluating this facet of board performance we looked for the existence and meeting frequency of each committee. Insider participation on committees continued to decline, and we saw only two cases where the CEO participated in the compensation committee.

We were surprised that eight companies still have an executive committee. ECs that act with the power of the full board create the potential for serious conflicts of interests.

Every company in gaming has an audit committee, and they met with a slightly higher frequency in 2009 than in 2008. (Archon was the only company without a compensation committee in 2009, stating that as a "controlled company" it was unnecessary.) The average frequency with which compensation committees met in 2009 increased over last year as well.

Nearly all companies combined their nominating and governance committees, which appeared appropriate in our view.

INSIDER PARTICIPATION, RELATED TRANSACTIONS

Under our broad definition, insider participation has remained stable, but related transactions have increased over last year. With several "controlled companies" in our survey this will never go away entirely, but the industry as a whole has done a good job in this area. Only four companies had insider participation while 10 had noteworthy related transactions. We believe that companies should discontinue these activities so there will never be a question about integrity and influence.

PAY-FOR-PERFORMANCE

Governance experts agree that management and shareholders must be committed to the same goals. A primary method for aligning the interests of both groups is a commitment to pay-for-performance. More than half of the industry has implemented the components of a well-designed compensation program, although virtually all of them espouse this as the underlying philosophy/goal of their executive compensation plans. This is perhaps the area where we have seen the most notable improvements over 2008. The components we look for are:

- A well-thought-out and articulated compensation philosophy
- Salaries that are set using a peer group analysis
- Quantifiable and detailed bonus metrics
- Long-term incentives that are performance-based and are not excessive
- Benefits and perquisites at appropriate levels.

In reviewing board director compensation we like to see a mix of cash and equity. Cash compensation that is broken down into attendance fees, committee participation fees and committee chair fees are preferable to retainers or other guarantees. While virtually all directors are receiving stock options we look for performance metrics and longer vesting periods as we feel these provide better incentives. We also like to see a policy that requires a level of stock ownership. Overall, board compensation in 2009 is better aligned with the important components we outline above.

In the area of executive compensation we looked for plans that articulate how incentives are tied to shareholder goals.

About the Authors

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BEST BOARDS OF 2009

COMPANY	SIZE & MAKEUP	COMMITTEE STRUCTURE	INSIDERS & RELATED TRANSACTIONS	PAY FOR PERFORMANCE	TOTAL
Boyd Gaming	6	10	10	9	35
Shuffle Master	10	8	10	6	34
Bally Technologies	9	10	5	9	33
Pinnacle Entertainment	9	7	10	7	33
Scientific Games	9	7	10	7	33
WMS Industries, Inc.	5	10	10	7	32
Multimedia Games	10	7	10	5	32
MGM Mirage	7	5	10	8	30
Churchill Downs	7	6	10	7	30
MTR Gaming	7	7	10	6	30
Penn National	8	7	5	9	29
IGT	4	8	10	7	29
Isle of Capri	6	6	10	7	29
Lakes Entertainment	7	6	10	6	29
Empire Resorts	6	8	10	5	29
Pokertek	7	7	10	5	29
Youbet	4	7	10	7	28
Full House Resorts	7	5	10	6	28
Daktronics	5	6	10	6	27
Global Cash Access	6	6	10	5	27
Gaming Partners International	6	6	10	4	26
Carnival	3	9	5	8	25
Canterbury Park	3	5	10	7	25
Elixir Gaming Technologies	6	8	5	6	25
Wynn Resorts	4	8	5	7	24
American Wagering	9	4	5	6	24
Nevada Gold	9	6	5	4	24
Monarch Casino	5	6	5	7	23
TransAct Technologies	2	5	10	6	23
GameTech International	6	6	5	5	22
Las Vegas Sands	2	5	5	8	20
Ameristar Casinos	2	6	5	7	20
Century Casinos	5	5	5	5	20
Dover Downs	6	4	5	3	18
Archon	2	3	5	5	15

Numerical values in each category represent the totals of points awarded for: optimal board size; independence of chairman; ratio of insider directors to independents; committee structure and meeting frequency; existence or absence of interlocks and insider participation; and compensation philosophy and practices.

The SEC and other governing bodies also believe that compensation committees should hire independent consultants to assist in making impartial decisions concerning compensation. (In the interest of full disclosure, HVS Executive Search is a leading provider of these services and has worked in the past with Century Casinos, Full House Resorts, Las Vegas Sands and Shufflemaster.)

We suspect that the scrutiny of executive compensation will intensify as shareholders look to reign in executive pay. Compensation committees will be further challenged finding ways to deal with stock option and grant programs that are so far underwater that they appear meaningless.

PERFORMANCE

The best performing board in this year's study was Boyd Gaming's. Bill Boyd and the entire board of directors should be proud of their work. Although Boyd has too many insiders, their committees were very active and had no insider participation or related transactions. In addition, Boyd's compensation philosophy was one of the best in the industry.

The other top five performers were Shufflemaster, Bally Technologies, Pinnacle Entertainment and Scientific Games.

We know more examination of director performance is coming, whether from the SEC, shareholders or activist groups. We counsel boards to be more thoughtful, transparent and communicative if they want to keep their constituencies happy.