

THE COMMONWEALTH OF MASSACHUSETTS
OFFICE OF THE ATTORNEY GENERAL

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December 5, 2007

Dr. John William Poduska, Sr.
Chairman of the Board of Directors
Citi Performing Arts Center, Inc.
270 Tremont Street
Boston, MA 02116

Re: Citi Performing Arts Center

Dear Mr. Poduska:

Under its authority to “enforce the due application of funds given or appropriated to public charities within the commonwealth and prevent breaches of trust in the administration thereof,” (see M.G.L. c. 12, s. 8), the Attorney General’s Office, through its Non-Profit Organizations/Public Charities Division (the “Division”), initiated an inquiry regarding certain actions of Citi Performing Arts Center, Inc. (formerly known as the Wang Center for Performing Arts, Inc. and hereinafter “Citi Center”) involving chief executive compensation and related party transactions. Citi Center, together with its subsidiaries Wang Theater, Inc., Tremont Theater, Inc., and Wang Center Productions, Inc., are each Massachusetts public charities and, as such, subject to the Division’s enforcement authority.

In particular the Division has reviewed matters related to: (i) compensation of Citi Center’s chief executive officer, Josiah A. Spaulding, Jr.; and (ii) payments by the Citi Center to (a) Joyce Spinney, Mr. Spaulding’s wife, (b) the public relations firm of Kortenhaus Communications, whose principal is Lynne Kortenhaus, a Citi Center director, and (c) the law firm of DLA Piper, whose managing partner in the Boston office is Elliot Surkin, also a Citi Center director. Our investigation comprised a review of certain Citi Center documents and interviews with you, John Cook, who serves as a director and treasurer; and Elliot Surkin, who serves as a director, clerk and primary legal counsel.

Direct or indirect payments to these persons or firms, if in amounts in excess of fair market value for the services rendered, could constitute a breach of trust in the administration of charitable funds. What constitutes fair market value for personal or professional service arrangements, such as the ones addressed herein, are among the most difficult issues that boards and regulators must address. While the use of market



comparables is appropriate and helpful, the wide range of evidentiary factors available and the intrinsically unique characteristics of such services, means that identifying precise comparables is difficult. As a result the Division is guided by criteria and procedures similar to those employed by the Internal Revenue Service pursuant to its so-called Intermediate Sanction Regulations (*see* Reg. §53.4958-6C), which look to the process utilized by the charitable entity in establishing the amount paid. More specifically we look for evidence of: (i) governing body involvement; (ii) use of independent sources of information and advice; (iii) lack of undue influence exerted by the compensated person; (iv) disclosure; and (v) concurrent documentation.

Based on our limited inquiry and for the reasons set forth hereinafter, we have concluded that the process utilized by the Citi Center board in approving executive compensation and related party transactions, while evidencing weaknesses in certain procedures and documentation, was within the range of what we would expect of the governing body of a public charity. As such, no further investigation into the fair market value of the services rendered is warranted. This conclusion is based solely on the information submitted to us. While this letter will end our inquiry into these matters, we have made certain recommendations with respect to board procedures and documentation which you have agreed to implement.

Our review of the matters addressed in this letter is limited to a legal assessment of whether the evidence establishes a violation of the Commonwealth's public charities laws. The Attorney General does not express, and nothing in this letter or our findings should be construed to express, any opinion on the business judgments of the Citi Center board or management including, without limitation, programming decisions.

I. Executive Compensation

During the five year period commencing with fiscal year 2002 (the first year of his five year contract), Citi Center's chief executive officer, Josiah A. Spaulding, Jr., was compensated in the following amounts: FY02 (\$513,000), FY03 (\$509,026), FY04 (\$504,000), FY05 (\$504,000) and FY06 (\$409,000). These amounts have been fully disclosed in Citi Center's annual filings with the Division. In addition, on July 21, 2006 Spaulding received a payout of his deferred stay bonus of \$1,238,000, which amount includes interest accrued at 10% per annum over the five year contract period.

Records of Citi Center indicate that as early as 1997 the importance of establishing a process for making executive compensation decisions was well understood. On May 21, 1997, the finance committee of the board first created a compensation subcommittee, which later became an independent standing committee of the board as a result of a bylaw amendment adopted by the full board of directors on September 24, 1998. At that meeting, the then chairman, David D'Alessandro, in a prepared presentation, recognized Internal Revenue Service, as well as media, scrutiny of executive compensation matters and emphasized the importance of justifying whatever compensation decisions were made. After noting that the IRS permitted the use of for-profit comparables, he described executive compensation arrangements in certain for-

profits, including an arrangement involving annual compensation of \$750,000 plus a multi-million dollar equity piece, which he considered comparable to the Citi Center. Elliot Surkin, Citi Center's counsel and a member of the compensation committee, has advised us that his firm consistently reminded the board of their obligations under Intermediate Sanctions Regulations as well as guidelines suggested by the Massachusetts Attorney General Board Members Guide.

At a meeting held on May 3, 2001,¹ the compensation committee approved a five year employment contract with Spaulding (the "Spaulding Contract"). The Spaulding Contract, which became effective on June 1, 2001 and expired on May 31, 2006, provided for an annual base salary of \$304,000, an annual performance bonus of up to \$200,000 and a deferred stay bonus of \$200,000 per year. You have advised us that the base and performance amounts under the Spaulding Contract were identical to those currently in place immediately prior thereto. Subject to certain limited exceptions not here relevant, the deferred stay bonus, which had not been in effect prior to June 1, 2001, was payable, with accrued interest at 10%, only at the end of five years and only if prior thereto Spaulding had not resigned or been terminated.

In reaching its 2001 decision on Spaulding's compensation², the compensation committee had before it at least two studies regarding market compensation: (i) a January 2001 report prepared by AMS Planning and Research Group for the Performing Arts Centers Consortium³ (the "2001 AMS Report") and (ii) a 1999 Compensation Survey prepared by Price Waterhouse Coopers and addressed to the Wang Center (the "1999

¹ Citi Center states that it has been unable to locate minutes for the May 3, 2001 compensation committee meeting. Counsel has stated that he had made a diligent search, but records may have been lost after he moved from the now dissolved firm of Hill and Barlow to his current firm, DLA Piper. Other evidence indicates that the meeting was held and the Spaulding Contract was approved by the committee. The meeting agenda, which we have reviewed, included action items to approve "incentive/retention compensation bonuses for key employees" and "the new President & CEO contract." Surkin also stated that he had participated in the meeting as a member of the compensation committee, described the committee's deliberations in approving a new contract for Spaulding, including a \$200,000/year stay bonus, and reported to a July 12, 2006 executive committee meeting that Mr. Spaulding's "recurring annual stay bonus" had been properly authorized and approved by the compensation committee. Indicative of its familiarity with stay bonuses, (i) the 1999 PWC Report (as later defined herein) noted stay bonuses as a portion of for-profit executive compensation packages and (ii) compensation committee minutes of May 8, 2002, in which the committee authorized Mr. Spaulding to set stay bonuses for other key employees, state "it was noted by the committee that in the long run it was less expensive to do retention bonuses than to pay a consultant to find new employees." Finally, Citi Center financial statements filed with the Attorney General since 2004 have noted that "the compensation committee designed the retention program to maintain continuity of key positions with the organization with guidance from compensation consultants."

² We were advised that although Spaulding was and remains a member of the compensation committee, he has neither participated in nor been present at any compensation committee discussions or actions involving his compensation.

³ The Performing Arts Centers Consortium, of which Citi Center is a member, is a consortium of approximately thirty of the largest performing arts centers in the country.

PWC Report”). The 2001 AMS Report, using annual budget based comparisons, noted a median of \$227,500 and a range of \$107,625 to \$500,000 for CEOs of comparable organizations. The 1999 PWC Report, which also used budget based comparisons, noted a range of \$180,000 to \$500,000 for non-profits; it also compared Spaulding’s then total compensation package of \$500,000 to data bases of the Economic Research Institute and W. T. Haigh & Company which reflected comparables of for-profit companies at levels, with stay bonuses, ranging from \$523,000 to \$554,000.⁴ We do not have minutes of the meeting and therefore do not have written documentation of the basis upon which the committee determined to establish Spaulding’s combined base and performance compensation at the top of the noted ranges and, assuming the eventual vesting of the deferred stay bonus, above the top of the noted ranges. Acknowledging that Spaulding’s compensation package was on the “high side” when compared with these ranges, Surkin stated that the committee intentionally made that decision in response to a desire that it be competitive with executive compensation packages at for-profit centers which were able to offer stock options to their senior management staff and, further, that the committee knew that for-profits such as Clear Channel, which was then renovating the Opera House, were increasingly competing with Citi Center and might well be competing for the services of Spaulding. We also note that D’Allesandro, in his 1998 presentation to the board, emphasized that non-profits could look to the for-profit sector in developing comparables to be used in executive compensation decisions and specifically referenced one arrangement in excess of \$750,000. We do not, however, have documentation of the referenced arrangement.

The Spaulding Contract provided that “the parties intend that [Spaulding] shall receive the entire amount of such annual [performance] bonus if [he] demonstrates high performance” in accordance with annual “high performance objectives” provided by the compensation committee and further stated that Spaulding would annually provide the committee with an evaluation of his performance in achieving the objectives. We have been advised that D’Allesandro discussed those objectives with Spaulding at the executive and finance committee meetings in the context of the preparation of each year’s budget; however there are no minutes of those meetings and these objectives were not documented in writing. During the first three years of the Spaulding Contract, agendas for compensation committee meetings attach detailed self evaluations completed by Spaulding, which the minutes state were reviewed at the meetings. Spaulding was awarded the full amount of the performance bonus for those years. Surkin advised us that Spaulding did not seek, and was not paid, a performance bonus in either of the final two years of the initial five year term and his compensation amounts confirm this.⁵

⁴ In addition to the above reports, combined minutes for the April 4, 2000 and June 8, 2000 compensation committee meetings state that the committee had reviewed compensation information provided by consultant Timothy Haigh (presumably the W.T. Haigh & Company whose database for for-profits was referenced in the 1999 PWC Report). In his 1998 presentation to the board, D’Alessandro had also referenced for-profit comparables; however no documentation of these other reports or comparables have been provided to us and we have no further information regarding their content or what reliance may have been placed upon them by the compensation committee.

⁵ Similar to performance bonus payment procedures in place prior thereto, the Spaulding Contract provided that payments of performance bonuses were deferred such that a performance bonus earned in any

At an October 12, 2005 executive committee meeting, Citi Center amended the Spaulding Contract (the "05 Amendment") to: (i) extend the term for two additional years (FY 07 and 08); (ii) increase his base pay from \$304,000 to \$400,000 for 07 and 08, and (iii) limit the presumptive performance bonus provisions of the Spaulding Contract to the first 3 years by providing that for contract years 4-7: "the Company may, in its sole discretion, pay Employee additional bonus compensation. The parties do not contemplate or intend that this Agreement be construed to imply any minimum or maximum amounts of bonus compensation for Contract Years 4-7." We have been advised that the 05 Amendment was initiated by Spaulding due to Citi Center's worsening financial condition. We were also advised by John Cook that the committee established the base amount of \$400,000 at a level slightly above the average for CEOs of comparable organizations because it was sensitive about losing Spaulding due to the reduction in pay⁶. While the 05 Amendment was never signed, it is our understanding that the parties have subsequently operated consistent with its terms.

Minutes of a June 14, 2006 executive committee meeting evidence discussion regarding Spaulding's now fully accrued deferred stay bonus and that Surkin proposed appointment of an ad hoc committee to review Spaulding's compensation. Minutes of the subsequent executive committee meeting of July 12, 2006 show that Surkin, reporting for the ad hoc committee, stated that Spaulding's "recurring annual stay bonus" had been properly authorized and approved by the compensation committee."

Consistent with the terms of the 05 Amendment, Spaulding's compensation for fiscal year 2007 (the first fiscal year subsequent to the expiration of the initial term of his 2001 contract) was \$400,000. This amount is consistent with a report provided to us by Citi Center titled "2006 PACC Salary Survey" prepared for the Performing Arts Centers Consortium by AMS Planning and Research Group (the "2006 AMS Report"). The 2006 AMS Report noted that the median 2006 compensation for CEO's of non-profit performing arts centers, with budgets comparable to Citi Center's, was \$416,250 and further stated that achievement of "financial results" had become the most important criterion of success for CEO performance evaluations in 2006.

Based on the foregoing, we have concluded that:

- (1) the Citi Center governing body, through the compensation committee, has been consistently involved in setting the compensation of, and reviewing the performance of, the chief executive officer;

given fiscal year would be paid in two equal installments: the first in July of the next fiscal year and the second in July of the following fiscal year.

⁶ The committee apparently relied upon a report provided to us by Citi Center titled "2004 PACC Salary Survey" prepared for the Performing Arts Centers Consortium by AMS Planning and Research Group, which noted that the average annual compensation for the time period covered was \$335,000 with a high of \$563,000.

- (2) the compensation committee did review and take into account independent sources of information regarding compensation package comparables;
- (3) we have seen no evidence of Mr. Spaulding exerting undue influence on the directors;
- (4) the compensation amounts, including the deferred stay bonus, have been consistently disclosed in annual filings with the Division; and
- (5) other than the meeting of May 2, 2001, minutes of the compensation committee reflect the major decision making events and substance.

While reasonable people may have differing opinions on the merits of Spaulding's compensation, it should be emphasized that the decisions that led to the current situation were set in motion over six years ago when the original contractual commitment was entered into and the performing art center landscape was, we are advised, quite different. Moreover, the five year contractual commitment limited the board's ability to unilaterally reduce executive compensation in response to those changes and it was only at the request and with the consent of Spaulding that his compensation was reduced by approximately \$100,000 in each of years four and five of the Spaulding Contract.

We must also note, however, that the process and record does reflect certain procedural lapses.

- (1) Given that as early as 1998 the board was aware of the scrutiny accorded executive compensation and that the compensation committee was well aware that the aggregate amount of the compensation approved in 2002 was above the high end of at least two non-profit studies they had before them (as well as the high end of the for-profit comparables in one of those studies), we believe the committee would have been better served with a more thoroughly documented record of the explanation for, and basis of, its decision to exceed those ranges. Without the missing minutes for the May 3, 2001 meeting, we are unable to determine whether such an explanation and basis may have been recorded.
- (2) While we recognize that the large size of the full board prior to the recent reorganization (it was then comprised of approximately 100 members) virtually compelled delegating significant authority to a committee of the board, placing a decision of the magnitude of the stay bonus exclusively in the hands of the small number of board members who comprised the compensation committee may have served to diminish oversight of what was clearly a very significant decision with long lasting impacts on the organization. We do note, however, that the majority of directors serving on the compensation committee were also the principal officers.
- (3) While a self evaluation of performance criteria may be helpful to the deliberative process, lack of clearly documented prospective performance objectives and a clearly

documented board or committee led performance review against those objectives, creates uncertainty regarding the standards applied to the granting of the performance bonuses.

II. Related Party Transactions

Kortenhuis Communications and DLA Piper

At all times relevant to our inquiry, Citi Center procured professional services from the law firm of DLA Piper⁷, whose managing partner in the Boston office is Elliot Surkin. For fiscal years 2004 – 2006 annual amounts paid by Citi Center to DLA Piper averaged \$113,269. Citi Center first hired Kortenhuis Communications in FY 2006 and paid it \$43,109 during that fiscal year. As both Kortenhuis and Surkin are directors of Citi Center, these related party transactions pose potential conflict of interests as persons in a position to influence decisions of Citi Center are in a position to personally benefit from those decisions. Recognizing the potential for abuse, both the Internal Revenue Service and this Division require disclosure of related party transactions in tax and annual report filings (see the Division form PC, question 24, and the IRS form 990, Part III, question 2).

Related party transactions are not unusual and, given a director's knowledge of the organization, such transactions can often be very beneficial to the charity. To address and minimize the potential for abuse, organizations routinely adopt conflict of interest policies that require board members and senior management to (i) disclose any relationships which might create a conflict of interest and (ii) provide a process whereby transactions can be entered into or renewed with related parties in a manner which assures the best interests of the organization are being served.

Citi Center's conflict of interest policy, dated 1999, (the "Conflict Policy") requires annual disclosure statements from all board members and other insiders. The Conflict Policy also provides that the compensation committee will review pending transactions that could involve conflicts of interest, determine whether the transactions constitute fair market value, and document its deliberations with meeting minutes.

We have been advised that fiscal year 2006 was the first year that Kortenhuis Communications provided services to Citi Center. Citi Center has a completed disclosure form for Kortenhuis for fiscal years 2006, 2007 and 2008 disclosing her relationship with Kortenhuis Communications. Her most recent disclosure form dated September of 2007 discloses that Kortenhuis charges no fees for her time and services to Citi Center and that her firm has provided public relations services at a reduced rate. We are advised that this reflects the arrangement in place since 2006. Returns and reports filed with the IRS and the Division for the 2006 fiscal year disclosed, as a related party transaction, the payment to Kortenhuis Communications.

⁷ Attorney Surkin moved to DLA Piper upon the dissolution in 2003 of Hill and Barlow which prior thereto had served as counsel to Citi Center.

Citi Center has produced forms completed by Surkin disclosing his law firm's status as Citi Center's corporate counsel for all years between 1999 and 2007, with the exception of 2001 and 2005. On the disclosure forms that were produced, Surkin disclosed that he charges no fee for his time and services to Citi Center and that his law firm provides services at a reduced rate. We are advised that this reflects the current arrangement. Returns and reports filed with the IRS and the Division for the same period each year disclosed (as payments to consultants) amounts paid to DLA Piper (or its predecessor Hill and Barlow); however only three of those reports (2000, 2001, 2006) also disclosed that those payments were to related parties.

The minutes of the compensation committee for the periods noted do not discuss any review of these arrangements in accordance with the Conflict Policy. We do note that the minutes of an April 11, 2007 executive committee meeting reflect that Kortenhaus offered her resignation "in order to avoid any appearance of a conflict." We have been informed that the executive committee declined her offer because it did not believe there was any issued requiring her resignation.

We are informed, and have no affirmative basis to conclude otherwise, that these arrangements were consistent with the best interests of Citi Center. Nevertheless, the board failed to provide for the periodic review of these arrangements as required by the Citi Center Conflict Policy.

Joyce Spinney

Joyce Spinney, who is currently employed as Citi Center's part time webmaster at an annual compensation of \$37,953, has been employed by Citi Center in various capacities since the fall of 1988. She was married to Spaulding in 1998, a fact that was disclosed to the full board at its meeting of September 24th of that year. While her status as an employed family member is not covered by the Conflict Policy, minutes of a March 10, 1999 meeting of the compensation committee reflect that it established her salary on the basis of market comparables and that she "reports to and is evaluated exclusively by (COO) William Taylor." Currently she reports to and is evaluated by Peter Fifield, Citi Center's CFO and head of its IT Department.

An August 2, 2000 memo from Paul Looby, Director of Human Resources for the Wang Center for the Performing Arts, stated that Spinney, who was then making \$68,796/year, was taking a 50% pay cut to work hours "approximately half of a typical full time employee in a comparable position," with her work time split between home and the office.

Spinney's employment by Citi Center is not subject to the Conflict Policy and we have no basis to conclude that her employment is not consistent with the best interests of Citi Center. We also note that the compensation committee established her compensation, she does not directly report to Spaulding, she was employed by Citi Center for ten years prior to her marriage to Spaulding, and the board was aware of the marital relationship.

III. Summary Conclusions and Recommendations

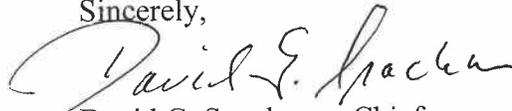
The board's procedures with respect to both Executive Compensation and Related Party Transactions were within the range of what we would expect and, while there were weaknesses and lapses, those do not warrant any enforcement action by this Division. Moreover we do believe that those weakness and lapses can be, and should be, easily rectified. As such, we have asked, and you have agreed, to undertake and implement the following.

- (1) Production and maintenance of minutes. While the agenda for the compensation committee meeting of May 2001 was maintained, Citi Center was unable to locate the minutes of that meeting. From a process perspective no organization should be in a position where only one copy of important corporate documents are maintained. The board should provide that minutes of all meetings are kept and backup copies (at least one of which is off site) are routinely maintained.
- (2) Executive Compensation. Decisions that place Citi Center in the position of being at the high end of the difficult arena of executive compensation should be subject to a more rigorous process and more detailed documentation than decisions that simply reflect the norm. We note that Spaulding's compensation, based on the 2006 AMS Report, is now at the median level of non-profit performing arts centers. In the event that changes in the future, or bonus or deferred stay provisions are adopted, we would strongly recommend the engagement of an independent consultant and the involvement of the full board in the ensuing decision making.
- (3) Performance Review. Regardless of whether or not Spaulding is eligible for a performance bonus, goals, objectives and performance criteria for a chief executive officer should always be recorded, in advance, by the board, or a duly authorized subcommittee thereof, and performance subsequently measured against those goals, objectives and criteria. Self evaluations are helpful, but are no substitute for an independent, documented governing body review against pre-established written standards.
- (4) Compliance with all aspects of the Conflict Policy. Citi Center's Conflict of Interest Policy is well written, thorough and appropriate. It should be rigorously complied with and compliance should be rigorously documented.
- (5) Disclosure of Related Party Transactions. Full disclosure of related party transactions on forms submitted to the Division has been inconsistent; in the future full disclosure should be consistent.
- (6) Spinney's compensation and performance. We have no reason to question the value of Spinney's services and, with appropriate reporting relationships, we do not believe that good governance requires the adoption of anti-nepotism policies. Given, however, her relationship to Spaulding, we do believe the organization would be well

served to have her performance and compensation periodically reviewed by the compensation committee.

Thank you and the Citi Center officers and staff for your cooperation.

Sincerely,

A handwritten signature in cursive script that reads "David G. Spackman". The signature is written in black ink and is positioned above the typed name and title.

David G. Spackman, Chief
Non-Profit Organizations/
Public Charities Division
617-727-2200 ext. 2110