

COMMUNICATIONS SYSTEMS INC  
Form DEF 14A  
April 10, 2013  
**Table of Contents**

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**SCHEDULE 14A**

Proxy Statement Pursuant to Section 14(a) of  
the Securities Exchange Act of 1934 (Amendment No. )

Filed by the Registrant  x

Filed by a Party other than the Registrant  o

Check the appropriate box:

- o Preliminary Proxy Statement
- o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- x Definitive Proxy Statement
- o Definitive Additional Materials
- o Soliciting Material Pursuant to §240.14a-12

**Communications Systems, Inc.**  
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- x No fee required.
- o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
  - (1) Title of each class of securities to which transaction applies:
  - (2) Aggregate number of securities to which transaction applies:
  - (3)

Edgar Filing: COMMUNICATIONS SYSTEMS INC - Form DEF 14A

Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

- (4) Proposed maximum aggregate value of transaction:
  - (5) Total fee paid:
    - o Fee paid previously with preliminary materials.
    - o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.
      - (1) Amount Previously Paid:
      - (2) Form, Schedule or Registration Statement No.:
      - (3) Filing Party:
      - (4) Date Filed:
-

**Table of Contents**

**COMMUNICATIONS SYSTEMS, INC.  
10900 Red Circle Drive  
Minnetonka, Minnesota 55343**

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**

**To Be Held May 21, 2013**

Dear Shareholders:

You are cordially invited to attend the Annual Meeting of Shareholders of Communications Systems, Inc. (the Company or CSI ). The meeting will be held at the Company's offices located at 10900 Red Circle Drive, Minnetonka, Minnesota, on Tuesday, May 21, 2013 beginning at 10:00 a.m., Central Daylight Time, for the following purposes:

1. To elect two directors to hold office until the 2016 Annual Meeting of Shareholders or until their successors are elected and qualified;
2. To ratify the appointment of Deloitte & Touche LLP as the Company's independent registered public accounting firm for the year ended December 31, 2013; and
3. To transact any other business that may properly come before the meeting.

The Board of Directors has fixed the close of business on March 26, 2013 as the record date for determination of shareholders entitled to notice of and to vote at the meeting.

You may attend the meeting and vote in person, or you may vote by proxy. *To ensure your representation at the meeting, please complete and submit your proxy, whether or not you expect to attend in person.*

Shareholders who attend the meeting may revoke their proxies and vote in person if they so desire.

By Order of the Board of Directors,

David T. McGraw  
Secretary

Minnetonka, Minnesota

April 9, 2013

**IMPORTANT NOTICE REGARDING AVAILABILITY OF PROXY MATERIALS:**

**Copies of this Notice, the Proxy Statement following this Notice and the Annual Report to Shareholders are available at [www.proxyvote.com](http://www.proxyvote.com)**

---

COMMUNICATIONS SYSTEMS, INC.

PROXY STATEMENT FOR MAY 21, 2013  
ANNUAL MEETING OF SHAREHOLDERS

TABLE OF CONTENTS

<u>QUESTIONS AND ANSWERS ABOUT THE MEETING</u>	1
<u>Information Regarding the Annual Meeting</u>	1
<u>What is the purpose of the meeting?</u>	1
<u>How does the Board recommend that I vote?</u>	1
<u>Who is entitled to vote at the meeting?</u>	1
<u>What is the difference between a shareholder of record and a street name holder?</u>	1
<u>What are the voting rights of the shareholders?</u>	1
<u>How many shares must be present to hold the meeting?</u>	1
<u>How do I vote my shares?</u>	1
<u>What does it mean if I receive more than one Notice of Internet Availability of Proxy Materials, proxy card or voting instruction card?</u>	2
<u>May I vote my shares in person at the meeting?</u>	2
<u>What vote is required for the proposals to be approved?</u>	2
<u>How are votes counted?</u>	2
<u>May I change my vote?</u>	2
<u>Who pays for the cost of proxy preparation and solicitation?</u>	3
<u>Why did I receive a notice in the mail regarding the Internet availability of proxy materials instead of a full set of paper copies?</u>	3
<u>How can a shareholder present a proposal at the 2014 Annual Meeting?</u>	3
<u>How can a shareholder get a copy of the Company's 2012 Report on Form 10-K?</u>	3
<u>What if I do not specify a choice for a matter when returning a proxy?</u>	3
<u>CORPORATE GOVERNANCE AND BOARD MATTERS</u>	4
<u>General</u>	4
<u>The Board, Board Committees and Meetings</u>	4
<u>Director Independence</u>	5
<u>Selecting Nominees for Election to the Board</u>	5
<u>Board Leadership</u>	5
<u>Board's Role in Managing Risk</u>	6
<u>Director Compensation</u>	6
<u>Code of Ethics and Business Conduct</u>	6
<u>Contacting the Board of Directors</u>	6
<u>PROPOSAL 1 - ELECTION OF DIRECTORS</u>	6
<u>Directors Proposed for Terms Expiring in 2016</u>	7
<u>Directors Serving Terms Expiring in 2014</u>	7
<u>Directors Serving Terms Expiring in 2015</u>	8
<u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT</u>	10
<u>Summary Ownership Table</u>	10
<u>Section 16(a) Beneficial Ownership Reporting Compliance</u>	12
<u>Five-Year Performance Graph</u>	12
<u>EXECUTIVE COMPENSATION AND RELATED INFORMATION</u>	13
<u>COMPENSATION DISCUSSION AND ANALYSIS</u>	13
<u>Compensation Philosophy and Objectives</u>	13

<u>Role of the Committee and the Information Used to Determine Compensation</u>	13
<u>Discussion of Executive Officer Compensation</u>	15
<u>Summary Regarding Components of Executive Compensation</u>	15
<u>Base Salaries</u>	15
<u>Annual Bonus Plan</u>	16
<u>Long-Term, Performance-Based Compensation</u>	17
<u>Stock Options</u>	20
<u>Other Compensation</u>	21
<u>Stock Ownership Guidelines</u>	21
<u>Consideration of Risk in Compensation</u>	21
<u>Compensation Committee Report</u>	22
<u>SUMMARY COMPENSATION TABLE</u>	22
<u>Non-Equity Incentive Plan Compensation Table</u>	23
<u>Other Compensation Table</u>	23
<u>Outstanding Equity Awards at Fiscal Year-End</u>	24
<u>Grants of Plan-Based Awards in 2012</u>	25
<u>POTENTIAL PAYMENTS UNDER CHANGE OF CONTROL</u>	26
<u>DIRECTOR COMPENSATION</u>	27
<u>PROPOSAL 2 RATIFICATION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</u>	28
<u>Independent Registered Public Accounting Firm Fees and Services</u>	28
<u>Audit Committee Pre-approval Policies and Procedures</u>	28
<u>Vote Required</u>	29
<u>Board Voting Recommendation</u>	29
<u>AUDIT COMMITTEE REPORT</u>	29
<u>CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS</u>	30
<u>OTHER INFORMATION</u>	30
<u>Directions to Company's Offices</u>	30
<u>Contacting the Board of Directors</u>	30
<u>Shareholder Proposals for 2014 Annual Meeting</u>	30
<u>Other Matters; Annual Report on Form 10-K</u>	31

## **Table of Contents**

### **COMMUNICATIONS SYSTEMS, INC. PROXY STATEMENT**

#### **QUESTIONS AND ANSWERS ABOUT THE MEETING**

##### **Information Regarding the Annual Meeting**

This Proxy Statement is furnished to the shareholders of Communications Systems, Inc. ( CSI or the Company ) in connection with the solicitation of proxies by the Board of Directors of the Company to be voted at the Annual Meeting of Shareholders that will be held at the Company's offices at 10900 Red Circle Drive, Minnetonka, Minnesota, on Tuesday, May 21, 2013, beginning at 10:00 a.m., Central Daylight Time, or at any adjournment or adjournments thereof.

##### **What is the purpose of the meeting?**

At our annual meeting, shareholders will act upon the two matters disclosed in the Notice of Annual Meeting of Shareholders that accompanies this Proxy Statement. These include

the election of two directors; and

ratification of the appointment of Deloitte-Touche, LLP ( Deloitte ) as our independent registered public accounting firm for the fiscal year ending December 31, 2013.

We will also consider any other business that may properly be presented at the meeting, and management will report on CSI's performance during the last fiscal year and respond to questions from shareholders.

##### **How does the Board recommend that I vote?**

The Board of Directors recommends a vote

FOR each of the nominees for director; and

FOR the ratification of the appointment of Deloitte.

##### **Who is entitled to vote at the meeting?**

If you were a shareholder of record at the close of business on March 26, 2013, you are entitled to vote at the meeting. As of the record date, 8,523,720 shares of common stock were outstanding and eligible to vote.

##### **What is the difference between a shareholder of record and a street name holder?**

If your shares are registered directly in your name, you are considered the shareholder of record with respect to those shares. If your shares are held in a stock brokerage account or by a bank or other nominee, you are considered the beneficial owner of those shares, and your shares are held in street name. If you are a street name holder you will receive a voting instruction card, which appears very similar to a proxy card. Please complete that card as directed in order to ensure your shares are voted at the meeting.

##### **What are the voting rights of the shareholders?**

Holders of common stock are entitled to one vote per share. Therefore, a total of 8,523,720 votes are entitled to be cast at the meeting. There is no cumulative voting for the election of directors.

##### **How many shares must be present to hold the meeting?**

A quorum is necessary to hold the meeting and conduct business. The presence of shareholders who can direct the voting of at least a majority of the outstanding shares of common stock as of the record date is considered a quorum. A shareholder is counted as present at the meeting if the shareholder is present and votes in person at the meeting or the shareholder has properly submitted a proxy by mail, telephone or Internet.

**How do I vote my shares?**

If you are a shareholder of record, you may give a proxy to be voted at the meeting either:

electronically, by following the instructions provided in the Notice of Internet Availability of Proxy Materials or proxy card; or

1

---

## **Table of Contents**

if you received printed proxy materials, you may also vote by mail or telephone as instructed on the proxy card.

If you hold shares beneficially in street name, you may also vote by proxy over the Internet by following the instructions provided in the Notice of Internet Availability of Proxy Materials or, if you received printed proxy materials, you may also vote by mail or telephone by following the instructions provided in the voting instruction card provided to you by your broker, bank, trustee or nominee. The telephone and Internet voting procedures have been set up for your convenience. The procedures have been designed to authenticate your identity, to allow you to give voting instructions, and to confirm that those instructions have been recorded properly. You may also vote in person at the meeting as described in **May I vote my shares in person at the meeting?** below.

### **What does it mean if I receive more than one Notice of Internet Availability of Proxy Materials, proxy card or voting instruction card?**

It means you hold shares of CSI stock in more than one account. To ensure that all of your shares are voted, sign and return each proxy card or voting instruction card or, if you vote by telephone or via the Internet, vote once for each proxy card, voting instruction card or Notice of Internet Availability of Proxy Materials you receive.

### **May I vote my shares in person at the meeting?**

Yes. If you are a shareholder of record, you may vote your shares at the meeting by completing a ballot at the meeting. Even if you currently plan to attend the meeting, however, we recommend that you submit your proxy ahead of time so that your vote will be counted if, for whatever reason, you later decide to not attend the meeting. If you hold your shares in street name, you may vote your shares in person at the meeting only if you obtain a signed proxy from your broker, bank, trustee or other nominee giving you the right to vote these shares at the meeting.

### **What vote is required for the proposals to be approved?**

Election of Directors. The two director nominees receiving the most votes for election will be elected directors.

Ratification of the appointment of Deloitte as our independent registered public accounting firm. The affirmative vote of a majority of the shares of common stock represented and entitled to vote on the proposal, if those shares represent more than 25% of the shares outstanding on the record date, is sufficient to approve the ratification of Deloitte.

### **How are votes counted?**

Shareholders may either vote FOR or WITHHOLD authority to vote for each nominee for the Board of Directors. Shareholders may vote FOR, AGAINST or ABSTAIN on the ratification of the appointment of Deloitte.

If you vote ABSTAIN or WITHHOLD, your shares will be counted as present at the meeting for the purposes of determining a quorum. If you ABSTAIN from voting on a proposal, your abstention has the same effect as a vote against that proposal. If you WITHHOLD authority to vote for one or more of the nominees for director, this will have no effect on the election of any director from whom votes are withheld.

If you hold your shares in street name and do not provide voting instructions to your broker or nominee, your shares will be considered to be broker non-votes and will not be voted on any proposal on which your broker or nominee does not have discretionary authority to vote under the rules of the New York Stock Exchange. Shares that constitute broker non-votes will be present at the meeting for the purpose of determining a quorum, but are not considered entitled to vote on the proposal in question. Your broker or nominee has discretionary authority to vote your shares on the ratification of Deloitte as our independent registered public accounting firm even if your broker or nominee does not receive voting instructions from you. Your broker or nominee may not vote your shares on the election of directors without instructions from you.

### **May I change my vote?**

Yes. If you are a shareholder of record, you may change your vote and revoke your proxy at any time before it is voted at the meeting in any of the following ways:

by sending a written notice of revocation to our Corporate Secretary;

by submitting another properly signed proxy card at a later date to our Corporate Secretary;





## **Table of Contents**

by submitting another proxy by telephone or via the Internet at a later date; or

by voting in person at the meeting.

If you are a street name holder, please consult your broker, bank, trustee or nominee for instructions on how to change your vote.

### **Who pays for the cost of proxy preparation and solicitation?**

We pay for the cost of proxy preparation and solicitation, including the charges and expenses of brokerage firms or other nominees for forwarding proxy materials to beneficial owners of shares held in street name.

We are soliciting proxies primarily by mail. In addition, proxies may be solicited by telephone or facsimile, or personally by our directors, officers and regular employees. These individuals will receive no compensation (other than their regular salaries) for these services.

### **Why did I receive a notice in the mail regarding the Internet availability of proxy materials instead of a full set of paper copies?**

In accordance with rules adopted by the Securities and Exchange Commission (the SEC), we may furnish proxy materials to our shareholders by providing access to these documents on the Internet instead of mailing printed copies. In general, you will not receive printed copies of the materials unless you request them. Instead, we mailed you the Notice of Internet Availability of Proxy Materials (unless you have previously consented to electronic delivery or already requested to receive paper copies), which instructs you as to how you may access and review all of the proxy materials on the Internet. The Notice of Internet Availability of Proxy Materials explains how to submit your proxy over the Internet. If you would like to receive a paper copy or e-mail copy of the proxy materials, please follow the instructions provided in the Notice of Internet Availability of Proxy Materials.

### **How can a shareholder present a proposal at the 2014 Annual Meeting?**

In order for a shareholder proposal to be considered for inclusion in our Proxy Statement for the 2014 Annual Meeting the written proposal must be received at our principal executive offices by the close of business on December 9, 2013. The proposal must comply with SEC regulations regarding the inclusion of shareholder proposals in company-sponsored proxy materials.

If a shareholder wishes to present a proposal at the 2014 Annual Meeting that would not be included in our Proxy Statement for that meeting, the shareholder must provide notice to us no later than April 6, 2014. Please contact the Corporate Secretary for a description of the steps to be taken to present such a proposal.

### **How can a shareholder get a copy of the Company's 2012 Report on Form 10-K?**

Our 2012 Annual Report, including our Annual Report on Form 10-K for the year ended December 31, 2012, is available electronically with this Proxy Statement. The 2012 Annual Report, including our Form 10-K is also available in the Investor Relations page of our website <http://commsysinc.com>. If requested, we will provide you copies of any exhibits to the Form 10-K upon payment of a fee covering our reasonable expenses in furnishing the exhibits. You can request exhibits to the Form 10-K by writing to the Corporate Secretary, Communications Systems, Inc., 10900 Red Circle Drive, Minnetonka, Minnesota 55343.

### **What if I do not specify a choice for a matter when returning a proxy?**

Unless you indicate otherwise, the persons named as proxies on the proxy card will vote your shares

**for** the election of each of the nominees to the board of directors set forth in proposal 1,

**for** the ratification of Deloitte as our independent registered public accounting firm set forth in proposal 2, and

if any other matters come up for a vote at the meeting, the proxy holders will vote in line with the recommendations of the board of directors or, if there is no recommendation, at their own discretion.

## **Table of Contents**

### **CORPORATE GOVERNANCE AND BOARD MATTERS**

#### **General**

Our Board of Directors is committed to sound and effective corporate governance practices. Our governance policies are consistent with applicable provisions of the rules of the Securities and Exchange Commission (the SEC) and the listing standards of the NASDAQ Stock Market (NASDAQ). We also periodically review our governance policies and practices in comparison to those suggested by authorities in corporate governance and the practices of other public companies.

You can access our corporate governance charters and other related materials by following links on the Corporate Governance page of our website <http://commsysinc.com>, or by writing to our Corporate Secretary at: Communications Systems, Inc., 10900 Red Circle Drive, Minnetonka, Minnesota 55343, or by sending an e-mail to our Corporate Secretary at [DavidM@commsysinc.com](mailto:DavidM@commsysinc.com).

#### **The Board, Board Committees and Meetings**

**Meeting Attendance.** Our Board of Directors meets regularly during the year to review matters affecting our Company and to act on matters requiring Board approval. Each of our directors is expected to make a reasonable effort to attend all meetings of the Board, applicable committee meetings and our annual meeting of shareholders. During 2012, the Board of Directors met six times. Each of our directors attended at least 75% of the meetings of the Board and committees on which he or she served, and all directors attended the 2012 Annual Meeting of Shareholders.

**Board Committees.** Our Board of Directors has established the following committees: Audit, Compensation, Governance and Nominating, Finance and Executive. Only members of the Board serve on these committees. Following is information about each committee:

**Audit Committee.** The Audit Committee is responsible for the engagement, retention and replacement of the independent registered public accounting firm, approval of transactions between the Company and a director or executive officer unrelated to service as a director or officer, approval of non-audit services provided by the Company's independent registered public accounting firm, oversight of the Company's internal controls and the receipt, retention and treatment of complaints regarding accounting, internal controls and auditing matters. Deloitte & Touche LLP, the Company's independent registered public accounting firm, reports directly to the Audit Committee. The Audit Committee operates under a formal charter that was most recently amended in August 2011. The current members of the Audit Committee are Edwin C. Freeman (Chair), Luella G. Goldberg, Roger H.D. Lacey, and Randall D. Sampson, each of whom is independent under SEC and NASDAQ rules. The Board of Directors has determined that Edwin C. Freeman qualifies as the Committee's financial expert. The Audit Committee met five times during 2012. The Audit Committee Report begins page 29.

**Compensation Committee.** The Compensation Committee is responsible for the overall compensation strategy and policies of the Company; reviews and approves the compensation and other terms of employment of the Company's chief executive officer and other executive officers, subject to final Board approval; oversees the establishment of performance goals and objectives for the Company's executive officers; administers the Company's incentive compensation plans; considers the adoption of other or additional compensation plans; and, provides oversight and final determinations with respect to the Company's 401(k) plan, employee stock ownership plan and other similar employee benefit plans. The Committee operates under a charter approved by the Board of Directors that was most recently amended in June 2008. The current members of the Compensation Committee are Gerald D. Pint (Chair), Edwin C. Freeman, Roger H. D. Lacey and Randall D. Sampson. Each of the members of the Compensation Committee is independent under NASDAQ standards. The Committee met four times in 2012.

**Governance and Nominating Committee.** The Governance and Nominating Committee is responsible for reviewing the size and composition of the Board, identifying individuals qualified to become Board members, recommending to the Board of Directors nominees to be elected at the annual meeting of shareholders, reviewing the size and composition of the Board committees, facilitating Board self-assessment and reviewing and advising the Board regarding strategic direction and strategic management. The Committee operates under a charter approved by the Board that was last amended in June 2008. The current members of the Governance and Nominating Committee are Luella G. Goldberg (Chair), Roger H. D. Lacey and Gerald D. Pint. Each of the members of the Governance and Nominating Committee is independent under NASDAQ listing standards. The Committee met two times during 2012.

## **Table of Contents**

**Finance Committee.** The Finance Committee is responsible for reviewing and approving the Company's annual business plan and related operating budgets. The Finance Committee interfaces with the Compensation Committee with respect to implementing compensation policies that support the Company's annual business plan. The Finance Committee is also responsible for overseeing and making recommendations about the financial operating policies and procedures relating to matters such as investment of excess cash, management of accounts receivable and inventory, purchases of capital equipment, travel, and employee benefits and perquisites. The current members of the Committee are directors Randall D. Sampson (Chair), Jeffrey K. Berg, Edwin C. Freeman, Curtis A. Sampson, and William G. Schultz. The Finance Committee met three times in 2012.

**Executive Committee.** Pursuant to Company's bylaws, the Executive Committee has the authority to act on behalf of the Board of Directors and the Company with respect to matters requiring Board action that arise between meetings of the Board or otherwise as it has been authorized to act by the Board of Directors. The current members of the Committee are Curtis A. Sampson (Chair), Jeffrey K. Berg, Luella G. Goldberg, Gerald D. Pint, and William G. Schultz. In addition to informal consultations during the year, the Executive Committee met once in 2012.

## **Director Independence**

The Board of Directors has adopted director independence guidelines that conform to the definitions of "independence" set forth in Section 301 of the Sarbanes-Oxley Act of 2002, Rule 10A-3 under the Securities Exchange Act of 1934 and listing standards of NASDAQ. In accordance with these guidelines, the Board of Directors has reviewed and considered facts and circumstances relevant to the independence of each of our directors and director nominees and has determined that each of the following directors qualifies as "independent" under NASDAQ listing standards: Edwin C. Freeman, Luella G. Goldberg, Roger H. D. Lacey, Gerald D. Pint and Randall D. Sampson. Three directors are not currently considered independent under NASDAQ listing standards: Curtis A. Sampson does not qualify as independent because of the level of consulting compensation he received in 2010 and earlier years; Jeffrey K. Berg does not qualify as independent because he served as the Chief Executive Officer of the Company within the past three years, and William G. Schultz does not qualify as independent because he is the current Chief Executive Officer of the Company.

## **Selecting Nominees for Election to the Board**

The Governance and Nominating Committee is the standing committee responsible for recommending to the full Board of Directors the nominees for election as directors at our annual shareholder meetings. In making its recommendations, the Committee reviews the Board composition to determine the qualifications and areas of expertise needed to further enhance the Board's ability to fulfill its responsibilities, and works with management in attracting candidates with those qualifications. Although the Committee does not have a formal policy regarding diversity in making its recommendations, in addition to minimum requirements of integrity, ability to make independent analytical inquiries, personal health and a willingness to devote adequate time and effort to Board responsibilities, the Committee seeks to have a Board that reflects diversity in background, education, business experience, skills, business relationships and associations and other factors that will contribute to the Board's governance of the Company.

In connection with making recommendations to the Board regarding nominees for election as directors, the Governance and Nominating Committee will consider qualified candidates that are proposed by our shareholders. Shareholders can submit qualified candidates, together with appropriate biographical information, to the Governance and Nominating Committee at: Communications Systems, Inc., 10900 Red Circle Drive, Minnetonka, Minnesota 55343. Submissions will be forwarded to the Governance and Nominating Committee for review and consideration. Any shareholder desiring to submit a director candidate for consideration at our 2014 Annual Meeting of Shareholders must ensure that the submission is received by the Company no later than December 10, 2013 in order to provide adequate time for the Governance and Nominating Committee to properly consider the candidate.

Shareholders may directly nominate an individual for election to the Board at our shareholders meeting by following procedures in our By-Laws. A shareholder wishing to formally nominate an individual to election to the Board at future shareholder meetings should follow the procedure set forth below under the caption "Other Information -- Shareholder Proposals for 2014 Annual Meeting -- Shareholder Nominations."

## **Board Leadership**

Our Governance Guidelines provide for separation of the roles of Chair of the Board and Chief Executive Officer. These positions are respectively held by Curtis A. Sampson and William G. Schultz. This structure enables

## **Table of Contents**

the Chair, in collaboration with other non-employee directors, to have an active role in setting agendas and establishing Board priorities and procedures.

### **Board's Role in Managing Risk**

In general, management is responsible for the day-to-day management of the risks the Company faces, while the Board, acting as a whole and through the Audit Committee, has responsibility for oversight of risk management. In its risk oversight role, the Board has the responsibility to satisfy itself that the risk management processes designed and implemented by management are adequate and functioning as designed. Member of senior management attend the regular meetings of the Board and are available to address questions and concerns raised by the Board related to risk management. In addition, our Board regularly discusses with management, the Company's independent registered public accounting firm and the internal auditor, identified major risk exposures, their potential financial impact on the Company, and steps that could be taken to manage these risks.

The Audit Committee assists the Board in fulfilling its oversight responsibilities with respect to risk management in the areas of financial reporting, internal controls and compliance with legal and regulatory requirements. The Audit Committee reviews the Company's financial statements and meets with the Company's independent registered public accounting firm and internal auditor at regularly scheduled meetings of the Audit Committee to review their reports on the adequacy and effectiveness of our internal audit and internal control systems, and to discuss policies with respect to risk assessment and risk management.

### **Director Compensation**

Compensation information paid to non-employee directors of the Company is set forth under the caption "Director Compensation" beginning on page 27.

### **Code of Ethics and Business Conduct**

We have adopted a Code of Ethics and Business Conduct (the "Code") applicable to all of the Company's officers, directors, employees and consultants that establishes guidelines for professional and ethical conduct in the workplace. The Code also contains a special set of guidelines applicable to the Company's senior financial officers, including the chief executive officer, principal financial officer, principal accounting officer, and others involved in the preparation of the Company's financial reports. These guidelines are intended to promote the ethical handling of conflicts of interest, full and fair disclosure in periodic reports filed by the Company, and compliance with laws, rules and regulations concerning this periodic reporting. A copy of the Code is available by following links on the "Corporate Governance" page of our website at <http://commsysinc.com>, and is also available, without charge, by writing to the Company's Corporate Secretary at: Communications Systems, Inc., 10900 Red Circle Drive, Minnetonka, Minnesota 55343.

### **Contacting the Board of Directors**

Any shareholder who desires to contact our Board of Directors may do so by writing to the Board of Directors, generally, or to an individual director at Communications Systems, Inc., 10900 Red Circle Drive, Minnetonka, Minnesota 55343. Communications received electronically or in writing are distributed to the full Board of Directors, a committee or an individual director, as appropriate, depending on the facts and circumstances described in the communication received. By way of example, a complaint regarding accounting, internal accounting controls or auditing matters would be forwarded to the Chair of the Audit Committee for review. Complaints and other communications may be submitted on a confidential or anonymous basis.

## **PROPOSAL 1 - ELECTION OF DIRECTORS**

The size and structure of the Board of Directors presently consists of eight director positions, divided into three classes, with each class of directors serving staggered three-year terms. Upon the recommendation of the Governance and Nominating Committee, the Board of Directors has nominated and recommends that the Company's shareholders elect Gerald D. Pint and Curtis A. Sampson, each of whom currently serves as a director, for three-year terms expiring in 2016. The Board of Directors believes that each nominee will be able to serve as a director. Should a nominee be unable to serve, however, the persons named in the proxies have advised the Company that they would vote for the election of such substitute nominee as the Governance and Nominating Committee may recommend and the Board of Directors may propose.

The following table sets forth information regarding the nominees named above and other directors filling unexpired terms, including information regarding their principal occupations currently and for the preceding five years.

**Table of Contents**

**Directors Proposed for Terms Expiring in 2016**

- Gerald D. Pint (77) GERALD D. PINT has been a director of CSI since 1997. He is currently a member of the Compensation Committee, serving as its Chair, and is also a member of our Governance and Nominating Committee and our Executive Committee. Since 1993, Mr. Pint has provided telecommunications consulting services and served on the boards of three public companies in addition to CSI: Hector Communications Corporation (2003 to 2006), Norstan, Inc. (1982 to 1997) and Inventronics Ltd. (1994 to 2004). From 1959 to 1993, Mr. Pint was employed by 3M Corporation and held various sales and management positions at 3M business units that were engaged in manufacturing and selling electronic and telecommunications products. In particular, from 1976 to 1982, Mr. Pint served as the Division Vice President of 3M's Telecom Products Division, and from 1982 until his retirement in 1993 he served as Group Vice President of 3M's Electro Telcom Group. Mr. Pint's background in and understanding of production and sales of telecommunications and electronics products, as well as his executive level management experience, derived from a 34-year career at 3M Corporation, provide a valuable perspective in the Board's governance of CSI's telecommunications and data communications related businesses.
- Curtis A. Sampson (79) CURTIS A. SAMPSON founded the Company in 1969 and has been a director since its inception. He currently serves as Chair of CSI's Board, and is also a member of the Board's Executive Committee and Finance Committee. He is also Chairman and a director of Canterbury Park Holding Corporation, a public company engaged in pari-mutuel and card club wagering. He is also a Regent of Augsburg College in Minneapolis, Minnesota and a member of the Emeritus Board of Overseers of the University of Minnesota's Carlson School of Management. Mr. Sampson was CSI's Chief Executive Officer from 1969 to June 2007, when he retired from full time executive responsibilities. While CEO, in addition to providing leadership to CSI's operations, Mr. Sampson managed numerous acquisitions and divestitures, including spin offs of two internally developed business units that were subsequently sold in transactions generating an aggregate of approximately \$200 million in cash for their shareholders. Over the course of his career, Mr. Sampson has also served on other non-profit boards, telephone industry association boards and private company boards, including service as a director of the following public companies: Hector Communications Corporation (2003 to 2006), Nature Vision, Inc. (2001 to 2009) and North American Communications Corporation (1986 to 1988). The distinctive perspective Mr. C.A. Sampson brings to the Board is his knowledge, gained over 40 years leading the Company, of CSI's business, operations, markets, vendors, customers and employees in combination with his experience in business acquisitions and divestitures, perspective gained from serving on other boards and extensive executive management experience.

**Directors Serving Terms Expiring in 2014**

- Edwin C. Freeman (57) EDWIN C. FREEMAN has been a director of CSI since 1988. He is currently a member of the Audit Committee, serving as its Chair, and is our audit committee's financial expert as that term is defined under the rules of the Securities and Exchange Commission. He is also a member of our Finance Committee and our Compensation Committee. Mr. Freeman currently serves as the Vice President and Chief Financial Officer of Bro-Tex Co., Inc. (paper and cloth wiper products, and carpet recycling) and has held other management positions in both operations and finance since joining Bro-Tex in March 1992. After receiving his MBA from the Harvard Business School in 1981, and before joining Bro-Tex, Mr. Freeman held positions in investment banking and strategic planning. Mr. Freeman brings strong executive management and financial management skills, as well as an in-depth knowledge of manufacturing processes similar to those used at CSI's production facilities. In addition, the Board benefits from Mr. Freeman's deep understanding of our business, our culture and our products that he has acquired during twenty years of service on our Board.
- Luella G. Goldberg (76) LUELLA G. GOLDBERG has been a director of CSI since 1997 and currently serves as a member of our Governance and Nominating Committee serving as its Chair, our Audit Committee and our Executive Committee. She also is a member of the Board of Overseers of the University of Minnesota's Carlson School of Management (1979 to Present), in addition to currently serving

**Table of Contents**

on boards of several other educational and non-profit organizations. Over the past 35 years Ms. Goldberg has served on the boards of a number of corporations, including the following public companies: TCF Financial Corporation (1988 to 2012), Hormel Foods Corporation (1993 to 2009), and the Supervisory Board of ING Group based in Amsterdam, Netherlands (2001 to 2008), which acquired ReliaStar Financial Corporation in 2001 (where she served as a director from 1976 to 2000). She also was a Trustee of the University of Minnesota Foundation from 1975 to 2008, including its Chair from 1996 to 1998, and is currently a Life Trustee of the Foundation. She also served as a trustee of Wellesley College from 1978 to 1996, including Chair of the Board from 1985 to 1993, and was Wellesley's Acting President from July to October 1993. Along with a number of other honors and awards that have recognized her achievements, in 2001 Ms. Goldberg received the Twin Cities Business Monthly's Lifetime Achievement Award as Outstanding Director. Because of her vast experience serving as a director of a myriad of significant for-profit, educational and philanthropic organizations, Ms. Goldberg brings special expertise in governance, as well as deep experience from a board perspective in addressing many of the wide variety of issues that the Company regularly faces.

Randall D.  
Sampson (54)

RANDALL D. SAMPSON has been a director since 1999. He currently serves as a member of our Finance Committee, serving as its Chair, and is also a member of our Audit Committee and our Compensation Committee. Mr. R.D. Sampson is the son of C.A. Sampson. Mr. R.D. Sampson is the President and Chief Executive Officer, as well as a member of the Board, of Canterbury Park Holding Corporation (CPHC), positions he has held since 1994. CPHC is a public company based in Shakopee Minnesota that, led by R.D. Sampson, re-launched a failed pari-mutuel race track and stimulated the revival of Minnesota's horse breeding and training industries. As a result, under his leadership, the Canterbury Park Racetrack has become a unique, family-friendly venue for live horse races and other entertainment, as well as pari-mutuel and card club wagering. Before becoming one of the three co-founders of CPHC in 1994, and after graduating from college with a degree in accounting, Mr. Sampson worked for five years in the audit department of a large public accounting firm where he earned his CPA certification, subsequently gained experience as a controller of a private company, served as a chief financial officer of a public company and managed Sampson family interests in horse breeding and training. The challenging nature of Canterbury Park's business has demanded from its CEO an entrepreneurial mindset, attention to expense control, continuous innovation in marketing, and attention to the needs of customers, which, along with other qualities, Mr. R.D. Sampson uniquely brings to the governance responsibilities of the CSI Board.

**Directors Serving Terms Expiring in 2015**

Jeffrey K. Berg  
(71)

JEFFREY K. BERG has been a director since 2007 and served as President and Chief Executive Officer of the Company from 2007 until his retirement in May 2011. Mr. Berg also serves as a member of our Executive Committee and Finance Committee. Mr. Berg joined CSI in 1989 and was appointed as President of CSI's Suttle subsidiary in 1992. Mr. Berg was named President of the Company in 2000, became CSI's Chief Operating Officer in 2002, and was appointed Chief Executive Officer in 2007. Before joining CSI, Mr. Berg was employed by AT&T from 1962 to 1989 where he was assigned management responsibility over various areas related to the production of AT&T's telecommunications products and equipment. At AT&T he gained experience in supervising manufacturing, quality control, human resources and IT elements of AT&T's telecommunications business, and also gained experience in product divestitures and plant relocations. After joining CSI and until being appointed Chief Operating Officer, Mr. Berg's experience was a mix of supervising manufacturing and providing leadership in sales and marketing. Mr. Berg brings to the Board a keen understanding of the telecommunications and data communications, extensive sales and marketing experience, personal relationships with key customers and demonstrated executive leadership abilities. Additionally, Mr. Berg's former role as our Chief Executive Officer gives him unique insights into our challenges, opportunities and operations.

**Table of Contents**

Roger H.D. Lacey (62) ROGER H.D. LACEY has been a director since 2008 and currently is a member of our Compensation Committee, Governance and Nominating Committee, and Audit Committee. Mr. Lacey was named Senior Vice President, Strategy and Corporate Development at 3M Corporation in 2010, and from 2000 to 2009 was 3M's Vice President, Corporate Strategy and Market Development. Mr. Lacey's career with 3M began in 1975, and from 1989 to 2000 he was assigned to 3M's Telecom Division, holding various positions including Division Vice President. He has also served as the General Manager of 3M's UK based Electro-Telecommunications Division. Mr. Lacey is currently a member of the Strategy Board based in Washington D.C., a member of The Conference Board -- Counsel of Strategic Planning Executives and Vice Chairman of Abbott Northwestern Hospital Foundation and University of St. Thomas Business School, both located in Minneapolis, Minnesota. Also, Mr. Lacey was a founding member of the Innovation Lab at MIT. In addition, as part of these duties for 3M, Mr. Lacey has also served on boards in China, Japan, Germany and Spain. Mr. Lacey brings a unique perspective that combines familiarity with opportunities and challenges presented in telecommunications and data communications markets around the world and deep experience in how strategic planning can be used to evaluate competing opportunities and optimize the use of a company's resources.

William G. Schultz (44) WILLIAM G. SCHULTZ became our President and Chief Executive Officer on May 19, 2011 in accordance with a planned succession process. Concurrent with his appointment as our CEO on May 19, 2011, the Company's directors elected Mr. Schultz to the CSI Board of Directors. Mr. Schultz currently serves as a member of the Executive Committee and Finance Committee. After receiving his MBA degree at the Goizueta Business School, Emory University, Mr. Schultz joined Transition Networks, a CSI business unit, in May of 2000 as a Product Manager. Prior to joining Transition Networks Mr. Schultz spent nine years with AMP/Tyco Electronics in a variety of roles including packaging engineering, sales, and channel management. In March 2001, Mr. Schultz became the Director of Marketing for Transition Networks and served in that role until 2002 when he was promoted to Vice President of Marketing. In October 2007, Mr. Schultz was named the VP and General Manager for Transition Networks. Effective May 2010, Mr. Schultz was named Executive Vice President of Operations, which included additional responsibilities for Suttle and Information Technology as well as running the Transition Networks business unit. This experience coming up through a CSI business unit has given Mr. Schultz experience in all facets of the business. He also established the engineering development office in Shanghai, China and has extensive international travel experience meeting with customers, distribution channels, and supply chain partners. His leadership and business skills helped to make Transition Networks the largest business unit in the CSI portfolio. This experience provided excellent preparation for Mr. Schultz becoming the President and CEO of CSI, and the insights he gained to the markets and activities of the business units while he served as Executive Vice President of Operations makes him a vital member of the Board.



**Table of Contents****SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT****Summary Ownership Table**

The following table sets forth certain information with respect to the Company's common stock beneficially owned by: (i) each person known by the Company to own of record or beneficially 5% or more of the Company's common stock, (ii) each director, (iii) each Named Executive Officer listed under Executive Compensation and Related Information, and (iv) all officers and directors of the Company as a group, in each case based upon information available as of March 26, 2013 (unless otherwise noted), and all shares subject to options reflect options that may be exercised within 60 days of March 26, 2013. All restricted stock units are excluded from the table because they will not be settled in common stock and delivered to the reporting person until May 22, 2014. Although the restricted stock units vest on May 21, 2013, the reporting person has no right to the shares until May 22, 2014.

<b><u>Name and Address of Beneficial Owner</u></b>	<b><u>Amount and Nature of Beneficial Ownership</u></b>	<b><u>Percent of Class</u></b>
Curtis A. Sampson	1,609,861 <sup>(1)</sup>	18.9%
Dimensional Fund Advisors LP Palisades West, Building One 6300 Bee Cave Road Austin, TX 78746	617,580 <sup>(2)</sup>	7.2%
William G. Schultz	592,041 <sup>(3)</sup>	6.9%
David T. McGraw	587,982 <sup>(4)</sup>	6.9%
John C. Ortman 1506 17th Street Lawrenceville, IL 62439	543,350	6.4%
Ira Albert 1304 SW 160th Avenue, Suite 209 Fort Lauderdale, FL 33326	519,151 <sup>(5)</sup>	6.1%
Putnam, LLC One Post Office Square Boston, MA 02109	497,856 <sup>(6)</sup>	5.8%
Randall D. Sampson	99,950 <sup>(7)</sup>	1.2%
Jeffrey K. Berg	79,035 <sup>(8)</sup>	*
Edwin C. Freeman	38,943 <sup>(9)</sup>	*
Luella G. Goldberg	38,626 <sup>(10)</sup>	*
Gerald D. Pint	27,226 <sup>(11)</sup>	*
Bruce Blackwood	12,852 <sup>(12)</sup>	*
Seweryn Sadura	10,382 <sup>(13)</sup>	*
Roger H.D. Lacey	8,226 <sup>(14)</sup>	*
Scott Fluegge	1,980 <sup>(15)</sup>	*
All directors and executive officers as a group (16 persons)	2,005,445 <sup>(16)</sup>	23.0%

Edgar Filing: COMMUNICATIONS SYSTEMS INC - Form DEF 14A

\* Indicates less than one percent ownership.

A Director or a Named Executive Officer of the Company.

- (1) Includes 599,514 shares owned by Mr. Curtis A. Sampson directly, 405,000 shares held indirectly in irrevocable trusts for the benefit of Mr. Sampson's children and grandchildren, of which Mr. Sampson is a trustee and as to which he disclaims beneficial interest, 24,614 shares owned by his spouse, as to which beneficial ownership is disclaimed, 9,000

**Table of Contents**

shares subject to options, and 571,733 shares owned by the Communications Systems, Inc. Employee Stock Ownership Plan ( CSI ESOP ), of which Mr. Sampson is a Trustee. Mr. Sampson disclaims any beneficial ownership of shares owned by the CSI ESOP in excess of the 42,836 shares allocated to his CSI ESOP account as of December 31, 2012. Excludes 3,697 restricted stock units that vest on May 21, 2013, but will not be settled in common stock and delivered to Mr. Sampson until May 22, 2014.

- (2) The aggregate number of shares held by Dimensional Fund Advisors LP ( Dimensional ) is owned by four investment companies and certain other commingled group trusts and separate accounts. In its role as investment advisor, Dimensional is deemed to have beneficial ownership of the securities as reported on Amendment No. 4 to Schedule 13G filed with the Securities and Exchange Commission on February 11, 2013.
- (3) Consists of 5,292 shares owed by Mr. Schultz directly, 15,016 shares subject to options and 571,733 shares owned by the CSI ESOP, of which Mr. Schultz is a Trustee. Mr. Schultz disclaims any beneficial ownership of shares owned by the CSI ESOP in excess of the 6,922 shares allocated to his CSI ESOP account as of December 31, 2012.
- (4) Includes 5,051 shares owned by Mr. McGraw directly, 11,198 shares subject to options and 571,733 shares owned by the CSI ESOP, of which Mr. McGraw is a Trustee. Mr. McGraw disclaims any beneficial ownership of shares owned by the CSI ESOP in excess of the 7,579 shares allocated to his CSI ESOP account as of December 31, 2012.
- (5) The aggregate number of shares listed above includes shares owned by Albert Investment Associates, L.P., shares owned by Ira Albert personally, and shares owned by accounts over which Ira Albert has discretionary voting and dispositive authority, as reported on the most recent Schedule 13D/A filed with the Securities and Exchange Commission on September 17, 2008.
- (6) The aggregate number of shares listed above are held by Putnam, LLC and Putnam Advisory Company, LLC, a wholly-owned subsidiary of Putnam, LLC, as reported on the most recent Schedule 13G/A filed with the Securities and Exchange Commission on February 14, 2003.
- (7) Includes 41,750 shares owned by Mr. Randall Sampson directly, 34,200 shares owned by his children, and 24,000 shares subject to option. Excludes 3,697 restricted stock units that vest on May 21, 2013, but will not be settled in common stock and delivered to Mr. Sampson until May 22, 2014.
- (8) Includes 21,584 shares owned by Mr. Berg directly, 35,270 shares issued upon the exercise of options, and 22,181 shares held in Mr. Berg s individual retirement account following a rollover from his CSI ESOP account. Excludes 3,697 restricted stock units that vest on May 21, 2013, but will not be settled in common stock and delivered to Mr. Berg until May 22, 2014.
- (9) Includes 14,943 shares owned by Mr. Freeman directly and 24,000 shares subject to options. Excludes 3,697 restricted stock units that vest on May 21, 2013, but will not be settled in common stock and delivered to Mr. Freeman until May 22, 2014.
- (10) Includes 14,626 shares owned directly by Ms. Goldberg and 24,000 shares subject to options. Excludes 3,697 restricted stock units that vest on May 21, 2013, but will not be settled in common stock and delivered to Ms. Goldberg until May 22, 2014.
- (11) Includes 3,226 shares owned directly by Mr. Pint and 24,000 shares subject to options. Excludes 3,697 restricted stock units that vest on May 21, 2013, but will not be settled in common stock and delivered to Mr. Pint until May 22, 2014.
- (12) Includes 5,800 shares subject to options and 7,052 shares allotted to Mr. Blackwood s CSI ESOP account at December 31, 2012.
- (13) Includes 775 shares owned directly by Mr. Sadura, 5,000 shares subject to options, and 4,607 shares allotted to his CSI ESOP account at December 31, 2012.
- (14) Includes 2,226 shares owned directly by Mr. Lacey and 6,000 shares subject to options. Excludes 3,697 restricted stock units that vest on May 21, 2013, but will not be settled in common stock and delivered to Mr. Lacey until May 22, 2014.
- (15) Includes 1,980 shares subject to options held by Mr. Fluegge.
- (16) Includes 755,880 shares owned by officers and directors as a group directly, 58,814 shares held by their respective spouses and children, 405,000 shares held in irrevocable trusts, 191,837 shares subject to option, 22,181 held in Mr. Berg s retirement account, and 571,733 shares owned by the CSI ESOP. Messrs. Curtis A. Sampson, David T. McGraw, and William G. Schultz serve as Trustees of the CSI ESOP, and disclaim beneficial ownership of the shares held by the CSI ESOP, except for shares allocated to their respective accounts.

**Table of Contents****Section 16(a) Beneficial Ownership Reporting Compliance**

The Company officers, directors and beneficial holders of 10% or more of the Company's securities are required to file reports of their beneficial ownership with the Securities and Exchange Commission on Forms 3, 4 and 5. According to the Company's records, all reports required to be filed during this period pursuant to Section 16(a) were timely filed.

**Five-Year Performance Graph**

The following graph presents, at the end of each of the Company's last five fiscal years, the cumulative total return on the common stock of the Company as compared to the cumulative total return reported for the NASDAQ (U.S.), and the NASDAQ Telecommunications Index. Company information and each index assume the investment of \$100 on the last business day before January 1, 2007 and the reinvestment of all dividends.

## Comparison of Five-Year Cumulative Total Return

<u>Company or Index</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Communications Systems, Inc.	\$ 100.000	\$ 69.833	\$ 117.385	\$ 139.049	\$ 144.724	\$ 113.343
NASDAQ US	100.000	61.172	87.928	104.131	104.686	123.849
NASDAQ TELCOM	100.000	57.458	86.159	111.247	117.637	158.937

12

## **Table of Contents**

### **EXECUTIVE COMPENSATION AND RELATED INFORMATION**

#### **COMPENSATION DISCUSSION AND ANALYSIS**

Communication Systems, Inc. (the Company) is a leading supplier of products for the data communications and telecommunications markets, and provides information system products and services for schools and businesses in southeast Florida. Our operations are organized and managed around our three primary business units: Suttle (Suttle), Transition Networks, Inc. (TNI) and JDL Technologies (JDL).

This Compensation Discussion and Analysis (CD&A) provides information regarding executive compensation objectives and policies, compensation plans for or applicable to the Company's Senior Executives (defined below), and compensation paid or potentially payable to the Senior Executive under these plans. This CD&A uses the following terms when discussing executive compensation:

**Board** means the Board of Directors of the Company.

**Committee** means the Compensation Committee appointed by the Board.

**Incentive Award** means the grant of an opportunity to earn compensation for long-term performance in cash or stock, or both, following the end of a multi-year period, but only if payment is justified by actual performance as compared to pre-established financial goals.

**Named Executive Officers** means the following five executives whose compensation is reported in the Summary Compensation Table immediately following this CD&A: William G. Schultz, our CEO; David T. McGraw, our CFO; Bruce Blackwood, the General Manager of Suttle; Seweryn Sadura, the General Manager of TNI; and, Scott Fluegge, Vice President and General Manager of JDL.

**Senior Executives** means a group consisting of the Named Executive Officers and other senior executives that collectively comprise our senior management team.

**Stock Option** means the right to purchase shares of the Company's common stock at an exercise price equal to the fair market value of the Company's common stock on the date the option is granted.

This CD&A discusses compensation of our Senior Executives generally and provides more detailed information regarding compensation of our Named Executive Officers.

#### **Compensation Philosophy and Objectives**

The Company's philosophy with respect to compensation of the Company's Senior Executives is based upon the following objectives:

To align compensation with shareholder interests;

To reward both annual and sustained long-term performance;

To provide pay opportunities comparable to opportunities at companies with which the Company competes for management talent; and

To maintain internally fair and equitable compensation levels and practices.

In furtherance of these objectives, over the last several years the Committee has placed increasing emphasis, on performance-based compensation. In addition, when determining how much performance-based compensation should be paid in Company stock versus cash, the Committee has, over the last several years, increasingly emphasized payment of this compensation in Company stock.

#### **Role of the Committee and the Information Used to Determine Compensation**

One of the Committee's primary responsibilities is to review and approve, or recommend for Board approval, compensation paid to the Company's Chief Executive Officer, other Named Executive Officers, and other Senior Executives. The Committee carries out this responsibility pursuant to a written charter adopted by the Board. The Committee consists of four independent directors that serve on our Board. See Corporate Governance and Board Matters Director Independence above. The Committee is also subject to Board oversight, and other members of the Board frequently participate in deliberations related to executive compensation. Additional information regarding the primary responsibilities of the Committee and its current members is provided above under the caption Corporate Governance and Board Matters the Board, Board Committees and Meetings.



## **Table of Contents**

### ***2012 Shareholder Advisory Vote***

In a non-binding, advisory vote at the Company's 2012 Annual Meeting of Shareholders, the Company's shareholder approved the Company's executive compensation program as presented in the Company's 2012 Proxy Statement. Of the shareholders voting on this matter, 78.8% voted to approve the Company's executive compensation, 11.7% voted against approval and 9.5% abstained. The Board and Compensation Committee are gratified by this favorable vote and do not intend to materially change the Company's current approach to executive compensation.

### ***Compensation Consultant***

Under its charter, the Committee has the authority to select, retain, and compensate executive compensation consultants and other experts as it deems necessary to carry out its responsibilities. From August 2010 through early-2011, the committee engaged Pearl Meyer & Partners (PM&P), a large, national compensation consulting firm, to conduct an extensive study of the overall structure of our compensation program and each of the primary components of our compensation program to determine whether we were paying competitive compensation, whether our approach was in line with best practices for public companies and whether we should change our approach to compensation to better align the interests of our Senior Executives with the interests of our shareholders. Based on the results of the study that PM&P completed in 2011 (the 2011 PM&P Study), the Committee and the Board approved a number of changes in 2011 to our approach to executive compensation (some of which are discussed in greater detail at various points in the remainder of this CD&A). In addition, the Committee generally relied on this study in making its 2012 executive compensation decisions.

### ***Comparative Data***

The Compensation Committee has adopted a practice of regularly comparing compensation it pays to Senior Executives to compensation paid by companies of similar size and scope (comparator group) so that it will have comparative data for assessing the Company's market position in compensation levels and practices. As part of the 2011 PM&P study, PM&P gathered data from a comparator group and determined median compensation paid for base salary, annual incentive compensation and long-term incentive compensation, as well as related compensation practices, and compared this information to compensation amounts and practices for the Named Executive Officers and other Senior Executives. Based on this comparison, PM&P made recommendations regarding 2011 executive compensation. Information in the 2011 PM&P Study also guided determinations of 2012 compensation of the Senior Executives.

In September 2012, the Committee engaged PM&P to update its 2011 study, including an update of the comparator group (the 2012 PM&P Study). The comparators used for the 2012 PM&P study consisted of the following companies (a group that includes 13 companies that were part of the comparator group in the 2011 study):

Digi International Inc.	Hutchison Technology, Inc.
Network Engines, Inc.	Nortech Systems, Inc.
ShoreTel, Inc.	KVH Industries Inc.
Oplink Communications, Inc	DTS Inc.
LoJack Corporation	Network Equipment Technologies Inc.
LeCROY Corporation	Meru Networks Inc.
Zhone Technologies, Inc.	Optical Cable Corp.
CalAmp Corp.	

The information in the 2012 PM&P Study validated that 2012 compensation of our Named Executive Officers was generally near the median of compensation paid by the comparator group, and was also used in connection with determinations regarding 2013 compensation of our Named Executive Officers.

### ***Internal Compensation Committee***

In determining compensation to be paid to the Named Executive Officers and other Senior Executives, the Committee solicits advice and recommendations from the Company's Internal Compensation Committee, which currently consists of four Company officers: the CEO, CFO, Vice President of Human Resources and Controller. However, neither the Internal Compensation Committee acting collectively, nor any of its members possess any authority to determine the amount or form of compensation paid to any Named Executive Officer or any other Senior Executive. The determination of compensation paid to the Named Executive Officers and other Senior Executives is entirely the responsibility of the Committee, subject to oversight by our Board.

**Table of Contents****Discussion of Executive Officer Compensation****Summary Regarding Components of Executive Compensation**

Total compensation paid to Senior Executives before 2011 consisted primarily of base salary, annual bonus compensation and Incentive Awards. Beginning in 2011 we added grants of Stock Options as a fourth, primary component to our executive compensation program. The following table summarizes:

Why we choose to pay each of these components to our Senior Executives;

What each component is designed to reward and form of payment; and,

How we determine the amount for each component.

<i>Element of Compensation</i>	<i>Why Component is Paid, Form of Payment &amp; What it Rewards</i>	<i>How Component Was Determined for FY 2012</i>
Base Pay	Provides a fixed level of cash income appropriate to the position.	Set at levels near median of market data
Annual Bonus Compensation	Based on the individual's experience, scope of responsibility and the level of performance. Provides incentive to achieve annual company wide or business unit objectives.	Target bonus as a percentage of base salary near median of market
Incentive Awards	Paid primarily in cash; stock grants for performance substantially greater than target goal.  Rewards achievement only if actual performance is within Committee-determined performance goals representing minimum, target and maximum levels of achievement. Provides an incentive to build long-term shareholder value based on achieving multi-year goals.	Grant date value of Incentive Awards as a percentage of base salary near median of market
Stock Options	Aligns executives to interests of shareholders.  Payout of 2012 Incentive Awards, if earned, occurs in 2015 and will consist of 75% stock and 25% cash.  Rewards superior long-term performance.  Facilitates executive retention. A right to purchase shares equal to market price when granted; option only valuable as stock price appreciates.  2012 stock options vest over 4 years.  Provides incentive for delivering long-term shareholder value and aligns interests of executives with shareholders.  Rewards superior long-term performance.  Facilitates executive retention.	Grant date value of Stock Options (based on the Black-Scholes valuation model) as a percentage of base salary near median of market

Over the next several pages we present further information regarding each of these components, as well as other benefits provided and compensation paid to our Senior Executives. is presented.

**Base Salaries**



Edgar Filing: COMMUNICATIONS SYSTEMS INC - Form DEF 14A

Base salaries of the Company's executive officers are established by reference to average base salaries paid to executives in similar positions with similar responsibilities using information supplied by PM&P and other

**Table of Contents**

sources. Base salaries are generally reviewed annually in December of each year and adjustments are made effective as of January 1 of the following year. From time to time, however, promotions and other events require adjustments at other points in the year. While emphasis is placed on measurable financial factors, when it determines base salaries the Committee also considers factors such as development and execution of strategic plans, changes in areas of responsibility, potential for assuming greater responsibility and the development and management of employees. The Committee does not, however, assign specific weights to these various quantitative and qualitative factors in reaching its decisions.

Adjustments in base salaries of our Named Executive Officers for 2012 were generally based on market data provided by PM&P in its 2011 study, but also reflect increases in compensation due to promotions of two Named Executive Officers. In 2011, Mr. Schultz was appointed as CEO and Mr. Sadura was appointed as General Manager of TNI. Reflecting an increase in compensation in their new positions, as presented in the Summary Compensation Table below, Mr. Schultz's 2012 base compensation increased 10.4% from his 2011 base compensation, and Mr. Sadura's base compensation increased 11% from his 2011 base compensation. Two Named Executive Officers, Mr. McGraw and Mr. Blackwood, each received 2% increases in their base compensation as compared to 2011. The fifth Named Executive Officer, Mr. Fluegge, joined the Company in December 2011 and did not receive a salary adjustment in 2012.

**Annual Bonus Plan**

Bonuses are paid to the Senior Executives following the end of each fiscal year based on achievement over the year in relation to objective financial goals set at the beginning of each year. These bonuses are intended to provide Senior Executives with an opportunity to receive additional, generally cash compensation, but only if justified by achievement in relation to pre-established financial goals.

At the beginning of each year, the Committee determines what objective performance measures it will use to assess financial performance by the Company overall and by each business unit. In addition, the Committee assigns a percentage weight to the various measures, with primary emphasis given to revenue and operating income. The Committee also determines specific quarterly, semi-annual and annual goals for each of these performance measures at threshold, target and maximum levels, both for overall Company performance and for business unit performance, with target goals being equal to amounts in the Company's budget.

In 2012, the performance measures selected by the Committee for the Company overall or one or more business units were: total revenue, new product revenue, international revenue, new business revenue, operating income, average age of receivables and inventory levels. The following table presents the performance measures assigned to the Company overall or to one or more of the business units and the relative weight assigned to each of the performance measures as used to determine 2012 annual bonus compensation:

	<u>Total Revenue</u>	<u>New Product Revenue</u>	<u>Inter 1 Revenue</u>	<u>New Business</u>	<u>Operating Income</u>	<u>Inventory</u>	<u>Receivables</u>
<b>Company</b>	30%	10%	10%	--	40%	5%	5%
<b>TNI</b>	30%	15%	15%	--	30%	5%	5%
<b>Suttle</b>	30%	20%	10%	--	30%	5%	5%
<b>JDL</b>	25%	--	--	50%	25%	--	--

Concurrent with determining and assigning weight to the various performance measures, and the goals against which achievement is measured, the Committee determines a target bonus opportunity and a maximum bonus opportunity that may be earned by each of the Senior Executives as a percentage of their base salary if actual performance exceeds applicable threshold performance goals. In 2012, the target annual bonus opportunity assigned to the Senior Executives ranged from 25% to 70% of their respective base salaries, and their respective maximum bonus opportunities were two times their respective target bonus opportunities if actual achievement equaled or exceeded maximum performance goals.

Bonuses paid to Named Executive Officers leading the entire enterprise, rather than a specific business unit (in 2012 Mr. Schultz and Mr. McGraw), are based on comparing the Company's actual consolidated 2012 performance to the goals for performance measures for overall Company actual performance. Bonuses paid to Named Executive Officers that lead business units (in 2012, Mr. Blackwood, Mr. Sadura and Mr. Fluegge) are based on comparing the performance of the leader's respective business unit to the goals for actual performance measures for that business unit. In all cases, one-half of each Senior Executive's bonus is determined based upon how well

**Table of Contents**

actual quarterly or semi-annual results of the entire enterprise or the business unit, as applicable, compare to the corresponding goals, and one-half of each Senior Executive's bonus is determined based upon how well twelve-month results of the entire enterprise or the business unit, as applicable, compare to annual goals.

Annual bonus compensation is generally determined after the end of each of the four quarters and after year end. At the end of each of the four quarters, the Company compares quarterly results to goals for all performance measures, other than receivables and inventory, and, in general, a bonus is paid with respect to each applicable performance measure if quarterly performance overall or for the business unit (as applicable) is at least 80% of the target goal for that performance measure. For two performance measures, receivables and inventory, a similar comparison is conducted only for the two semi-annual periods. Similarly, following the end of the year, twelve-month results are evaluated in comparison to annual target performance goals for each of the performance measures described above, and, in general, a bonus is paid with respect to each applicable performance measure if annual performance is at least 80% of the goal for that performance measure. While bonuses are paid primarily in cash, under the Annual Bonus Plan stock grants are made in lieu of cash when actual quarterly and annual revenues exceed 110% of target revenues for the quarter or the full fiscal year.

The following table summarizes the total amount paid in cash under the Company's 2012 Annual Bonus Plan to the Company's Named Executive Officers as compared to the target bonus set at the beginning of the year. No stock grants were earned under the Annual Bonus Plan in 2012.

<u>Name of Senior Executive</u>	<u>2012 Target Bonus as % of Base Compensation</u>	<u>Target 2012 Bonus (\$)</u>	<u>2012 Annual Bonus Paid in Cash (\$)</u>
Mr. Schultz	70%	\$ 203,490	\$ 27,042
Mr. McGraw	55%	139,128	18,489
Mr. Blackwood	50%	94,350	83,715
Mr. Sadura	50%	87,500	17,499
Mr. Fluegge	50%	82,500	3,342

**Long-Term, Performance-Based Compensation**

*Company's Long-Term Incentive Compensation Plan Prior to 2011*

The Company has granted Incentive Awards to its Named Executive Officers, other Senior Executives and other key employees (collectively Participants) since 2004. Prior to 2012 these awards were made under the Company's Performance Unit Plan.

Under the Performance Unit Plan, performance was, in general, measured over four-year Performance Periods that commenced at the beginning of each even-numbered year. For each Performance Period: (i) performance measures and related performance goals denominated as Threshold, Target and Maximum were determined for the Company and each of its business units, and (ii) each Participant was assigned an opportunity (expressed in dollars) to earn long-term incentive compensation based on the level of his or her responsibility within the Company or a Company business unit to the extent actual achievement justified such compensation when compared to Threshold, Target and Maximum performance goals for the Company or business unit (as applicable). Following the end of the Performance Period, if Company or business unit performance, as applicable, over the four year period was at or above Threshold in relation to the applicable performance goals and the Participant was still employed by the Company, each Participant was paid incentive compensation, generally in cash, based on his or her respective Target Opportunity (up to his or her Maximum Opportunity) commensurate with the Company's performance or business unit performance as compared to applicable Threshold, Target and Maximum performance goals.

The two Performance Periods most recently established under the Performance Unit Plan Plan were the 2008-2011 Performance Period and the 2010-2013 Performance Period. Long-Term incentive compensation earned for the 2008-2011 Performance period was paid entirely in cash after completion of the audit of 2011 financial results. At the beginning of the 2010-2013 Performance Period, based on PM&P's recommendation, the

**Table of Contents**

Company transitioned to a new approach to determining and paying long-term incentive compensation. A key element of this new approach was changing the frequency and term of Incentive Awards so that, rather than starting a new four-year performance period every other year, Incentive Awards would be based on a three-year performance period starting every year. Because, at the time the Board determined to make this change, a four year period (2010 – 2013) had already commenced, it was decided the entire 2010 – 2013 Performance Period would be divided into a 2010 stand-alone year and a three-year performance period beginning in 2011 and ending in 2013. Also, as recommended by PM&P, the Committee approved paying long-term incentive compensation at least partly in stock, and it specifically determined that of any payout for the 2010 stand-alone year would be paid 50% in stock and 50% in cash. Finally, to complete the transition to its new approach to long-term executive compensation, the Company amended the Performance Unit Plan in 2011, including changing its name to Long-Term Incentive Plan, and, pursuant to the amended plan, the Committee granted Incentive Awards and Stock Options to Senior Executives based on a framework, methodology and other policy considerations substantially the same as described immediately below in regard to 2012 long-term, performance-based compensation.

**Overview of 2012 Long-Term, Performance-Based Compensation**

The Company currently provides two forms of long-term, performance-based compensation to its Senior Executives:

Incentive Awards, which provide for payouts in cash and stock after the end of three-year performance periods to the extent justified by actual performance compared to performance goals.

Stock Options, which are granted on an annual basis, vest over four years, and only offer value to the executive if the Company's stock price increases over the option exercise price.

Incentive Awards and Stock Options granted to our Senior Executives are determined under a unified framework under which the Committee first determines the total opportunity (expressed in dollars) that each Senior Executive will be given to earn long-term incentive compensation ( Total Target LTI Opportunity ). The Total Target LTI Opportunity for each Senior Executive is determined as a percent of each executive's base salary. In 2012, using data from the 2011 PM&P Study, the Committee assigned a Total Target LTI Opportunity to the Senior Executives as a percentage ranging from 20% to 100% of their respective 2012 base compensation. Also, based on PM&P's recommendation as to market practices, the Committee allocated 70% of each executive's Total Target LTI Opportunity for an Incentive Award grant and 30% for a Stock Option grant.

The following table presents for each Named Executive Officer, the percent of base compensation that was used to determine that officer's respective Total Target LTI Opportunity, the grant date dollar value of the Total Target LTI Opportunity, and the allocation of this total dollar value to grants of Incentive Awards and grants of Stock Options.

	<b>2012 Base</b>	<b>Total Target LTI Opportunity</b>		<b>Allocation of Total Target LTI Opportunity:*</b>	
		<b>% Base Salary</b>	<b>Grant Date Value</b>	<b>Incentive Awards</b>	<b>Stock Options</b>
Mr. Schultz	\$ 290,700	100%	\$ 290,700	\$ 203,490	\$ 87,210
Mr. McGraw	\$ 252,960	60%	\$ 151,776	\$ 106,243	\$ 45,533
Mr. Blackwood	\$ 188,700	40%	\$ 75,480	\$ 52,836	\$ 26,644
Mr. Sadura	\$ 175,000	40%	\$ 70,000	\$ 49,000	\$ 21,000
Mr. Fluegge	\$ 165,000	40%	\$ 66,000	\$ 46,200	\$ 19,800

\* Allocated, respectively, 70% to Incentive Awards and 30% to Stock Options.

**2012 Incentive Awards**

Incentive Awards were granted to the executives in 2012 under the Company's Long-Term Incentive Plan or LTI Plan. The LTI Plan provides that Incentive Awards may be paid out in Company stock or cash to the

**Table of Contents**

extent earned in relation to long-term performance goals. However, over the last three years the company has placed increased emphasis on paying Incentive Awards primarily in Company stock.

Long-term performance is measured over three-year Performance Periods that are established every year. Under the LTI Plan, at the beginning of each three-year performance period, the Company selects objective performance measures for assessing financial performance and determines Minimum, Target and Maximum performance goals for each measure. For Incentive Awards covering the 2012 - 2014 Performance Period, the Committee selected consolidated pretax average return on assets over the three-year period ( Three Year Average ROA) and consolidated cumulative revenue over the three-year period ( Three Year Cumulative Revenue ), and established Minimum, Target, and Maximum performance goals for each of these performance measures. Also, at the beginning of 2012, Incentive Awards were granted to each Senior Executive for the 2012 - 2014 performance period, and each award provided for a Target opportunity to earn cash and stock having a value equal to 70% of the executive's Total LTI Opportunity, if the Target performance goals are achieved, and a Maximum opportunity two times the amount of the Target opportunity, if the performance goals at Maximum are achieved.

Following the end of fiscal 2014, the Committee will determine the amount payable under the 2012 Incentive Awards by comparing actual performance against the goals. The Committee will measure actual consolidated pretax return on assets ( ROA Achievement ) compared to Minimum, Target and Maximum performance goals for the Three Year Average ROA and will measure actual revenue (Revenue Achievement) compared to Minimum, Target and Maximum performance goals for the Three Year Cumulative Revenue. In each case, actual performance equal to or less than the Minimum performance goal will represent 0% achievement, actual performance equal to the Target performance goal will represent 100% achievement, and actual performance at or above the Maximum performance goal will represent 200% achievement. Actual ROA Achievement and Revenue Achievement will then be plotted on a matrix where one axis represents performance goals for Three Year Average ROA over the range from Minimum to Target to Maximum, and the other axis represents performance goals for Three Year Cumulative Revenue over the range from Minimum to Target to Maximum. The intersection of ROA Achievement and Revenue Achievement on the matrix will determine a percentage that will be multiplied by the amount of the Target opportunity specified in the Incentive Award for each Senior Executive to determine the payout earned by that executive.

The following table provides hypothetical payouts of Incentive Awards as a percentage of the Target LTI Opportunity for the award based on various hypothetical combinations of ROA Achievement and Revenue Achievement.

<b>ROA Achievement Compared to Performance Goals</b>	<b>Revenue Achievement Compared to Performance Goals</b>	<b>Payout of Incentive Award as a Percentage of Target Opportunity</b>
ROA Achievement less than or equal to Minimum Performance Goal	Revenue Achievement less than or equal to Minimum Performance Goal	0%
ROA Achievement at mid-point between Minimum Performance Goal and Target Performance Goal	Revenue Achievement at mid-point between Minimum Performance Goal and Target Performance Goal	70.83%
ROA Achievement equal to 100% of Target Performance Goal	Revenue Achievement equal to 100% of Target Performance Goal	100%
ROA Achievement at mid-point between Target Performance Goal and Maximum Performance Goal	Revenue Achievement at mid-point between Target Performance Goal and Maximum Performance Goal	141.67
ROA Achievement equal to or greater than Maximum Performance Goal	Revenue Achievement equal to or greater than Maximum Performance Goal	200%

**Table of Contents**

The amount earned for the 2012 Incentive Awards, when determined after 2014, will be paid 75% in Company stock and 25% in cash. With regard to payment in Company stock, the number of shares that are issued following the end of the performance period will be determined by dividing 75% of the total payout earned under the Incentive Award divided by \$13.58, which represents the average closing price for CSI stock over the 20 business days ending March 28, 2012.

The following table shows the amount of cash that may be paid and shares of stock that may be issued to the Named Executive Officers at Target and Maximum Levels of Performance for the 2012 – 2014 performance period under the Company's LTI Plan. As explained above, if achievement is below the Target performance goals, the amount cash and stock compensation earned will be less than the Target opportunity, and if achievement fails to meet the Minimum performance goals, the participant will not be entitled to any payment.

Named Executive Officer	Target Incentive Opportunity Payable under the LTI Plan			Maximum Incentive Opportunity Payable under the LTI Plan		
	Total*	Potential Cash Payment	Potential Shares Issuable	Total	Potential Cash Payment	Potential Shares Issuable
Mr. Schultz	\$ 203,490	\$ 50,873	11,238	\$ 406,980	\$ 101,745	22,476
Mr. McGraw	\$ 106,243	\$ 26,561	5,868	\$ 212,486	\$ 53,122	11,736
Mr. Blackwood	\$ 52,836	\$ 13,209	2,918	\$ 105,672	\$ 26,418	5,836
Mr. Sadura	\$ 49,000	\$ 12,250	2,706	\$ 98,000	\$ 24,500	5,412
Mr. Fluegge	\$ 46,200	\$ 11,550	2,552	\$ 92,400	\$ 23,100	5,104

\* 70% of executive's total LTI Opportunity

**Stock Options**

We grant Stock Options as the second component of our long-term, performance-based compensation program for Senior Executives. Because stock options only deliver value if the price of the Company's stock increases over the term of the option, we believe this provides a further and distinctive form of motivation for executive performance. We determined the number of shares covered by options granted to each Senior Executive in 2012 by dividing 30% of the dollar value of the Total Target LTI Opportunity allocated to such executive as discussed above by \$2.50, an amount determined by using a Black Scholes valuation for the options based on a share price of \$13.10. The exercise price of each option is \$13.10 (the closing market price on March 15, 2012); and, each option vests 25% each year beginning March 15, 2013 and expires February 28, 2019.

The following table presents stock options granted to the Named Executive Officers in 2012:

<u>Name of Senior Executive</u>	<u>Value of LTI Opportunity Allocated to Stock Options*</u>	<u>Shares Covered by Option Grant</u>
Mr. Schultz	\$ 87,210	34,884
Mr. McGraw	\$ 45,533	18,213
Mr. Blackwood	\$ 22,644	9,058
Mr. Sadura	\$ 21,000	8,400
Mr. Fluegge	\$ 19,800	7,920

\* 30% of executive's total LTI Opportunity



## **Table of Contents**

### **Other Compensation**

In addition to participating in Company-wide plans providing health, dental and life insurance on the same basis as all of our other U.S. based employees, our Senior Executives receive other compensation in various forms, primarily the following:

An annual contribution to the Company's Employee Stock Ownership Plan and Trust ( ESOP ), that is generally equal to 3% of the executive's W-2 income, which is used to acquire shares of the Company's stock that are beneficially owned by the Executive inside the ESOP.

An annual matching contribution of up to 50% of each executive's personal contribution to the Company's 401(k) Plan up to the first 6% of such personal contribution.

A car allowance or company car.

In individual, unique circumstances, additional compensation to support an overseas assignment or travel to a residence away from the Company's offices.

The amount of such other compensation for our Named Executive Officers is presented in the column titled "All Other Compensation" under the "Summary of Executive Compensation Table," and the "Other Compensation Table."

### **Stock Ownership Guidelines**

The Company has adopted guidelines for stock ownership by our Senior Executives. For our Chief Executive Officer, the guideline is beneficial ownership of shares valued at three times base salary; for our Chief Financial Officer the guideline is beneficial ownership of shares valued at two times base salary; and, for all other Senior Executives, guideline is being a beneficial owner of shares having a value equal to one times base salary. Stock ownership includes shares held directly and shares beneficially held in the Company's ESOP, but does not include unexercised stock options or shares potentially payable under Incentive Awards. Executives are expected to achieve their guideline amount within seven years from March 2011 and the Company will annually review progress towards achieving ownership equal to the ownership guidelines.

### **Consideration of Risk in Compensation**

The Company believes placing substantial emphasis on long-term incentive compensation encourages executives to direct their efforts to promote the creation of long-term shareholder value and that promoting the creation of long-term value discourages behavior that leads to excessive risk. The Committee believes that the following features of our compensation programs provide incentives for the creation of long-term shareholder value and encourage high achievement by our executive officers without encouraging inappropriate or unnecessary risk taking:

We balance rewards for short and long-term decision making by providing both annual bonus compensation and long-term incentive compensation.

Our long-term incentives in the form of stock options become exercisable over a four-year period and remain exercisable for up to seven years from the date of grant.

Our Incentive Awards become payable only if, after completion of a multi-year period, actual performance over the period compared to pre-established performance goals justifies a payment.

Because of our stock ownership guidelines, officers and key employees require all executives to make progress towards owning stock equal to at least one times their base compensation, we believe our Named Executive Officers would become less likely to expose the Company to inappropriate or unnecessary risks.

The financial metrics used in our incentive compensation programs are measures the Committee believes drive long-term shareholder value. Moreover, the Committee attempts to set ranges for these measures that encourage success without encouraging excessive risk taking to achieve short term results. In addition, all forms of incentive compensation specify a maximum amount that cannot exceed two times the target amount, no matter how much financial performance exceeds the ranges established at the beginning of the year.



**Table of Contents****Compensation Committee Report**

The Committee has reviewed the Compensation Discussion and Analysis set forth above. Based upon this review, the Committee recommended to the Board that the Compensation Discussion and Analysis be included in this Proxy Statement.

**SUBMITTED BY THE COMPENSATION COMMITTEE****OF THE COMPANY'S BOARD OF DIRECTORS**

Gerald D. Pint (Chair)

Edwin C. Freeman

Roger H.D. Lacey

Randall D. Sampson

**SUMMARY COMPENSATION TABLE**

The following table presents information regarding compensation earned in 2012, 2011, and 2010 for services in all capacities by (i) William G. Schultz, the Company's Chief Executive Officer, (ii) David T. McGraw, the Company's Chief Financial Officer, and (iv) the three other most highly compensated executive officers of the Company in 2012 (together referred to as the "Named Executive Officers").

<b>Name and Principal Position</b>	<b>Year</b>	<b>Salary (\$)</b>	<b>Stock Awards (\$ (1))</b>	<b>Options Award (2) (#)</b>	<b>Non-Equity Incentive Plan Compensation (\$ (3))</b>	<b>All Other Compensation (\$ (4))</b>	<b>Total (\$)</b>
William G. Schultz President and Chief Executive Officer	2012	290,700	-	87,210	27,042	23,750	428,702
	2011	263,269	9,071	34,623	274,879	16,461	598,303
	2010	201,842	19,711	-	203,175	11,783	436,511
David T. McGraw Chief Financial Officer	2012	252,960	-	45,533	18,489	21,454	338,436
	2011	248,000	-	36,548	233,340	21,200	546,110
	2010	239,630	-	-	255,264	17,173	538,352
Bruce Blackwood Vice President and General Manager, Suttle	2012	188,700	-	21,000	83,715	45,372	338,486
	2011	185,000	-	19,443	70,066	42,583	317,092
	2010	176,000	-	-	88,028	40,041	304,069
Seweryn Sadura Vice President and General Manager, Transition Networks	2012	175,000	-	22,645	17,499	19,815	234,459
	2011	157,500	12,305	15,950	97,489	18,881	302,125
	2010	108,293	-	-	42,981	30,508	181,782
Scott Fluegge Vice President and General Manager, JDL Technologies (5)	2012	165,000	-	19,800	3,342	9,878	198,020
	2011	6,346	-	-	-	-	6,346
	-	-	-	-	-	-	-

(1) Represents stock earned under the Company's Annual Bonus Plan and Long-Term Incentive Plan ("LTI Plan"). The values expressed represent the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 and Item 402(r)(2)(iv) of Regulation S-K, using the assumptions discussed in Note 9, "Stock Compensation" in the notes to consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2012. For further information see CD&A - Discussion of Executive Officer Compensation.

(2) Represents options awarded under the Company's 1992 Stock Plan. The values expressed represent the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 and Item 402(r)(2)(iv) of Regulation S-K,

**Table of Contents**

using the assumptions discussed in Note 9, Stock Compensation, in the notes to consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2012. For further information see CD&A- Discussion of Executive Officer Compensation.

- (3) Represents amounts earned under the Company's Performance Unit Plan. See Non-Equity Incentive Plan Compensation Table below.
- (4) See Other Compensation Table below.
- (5) Mr. Fluegge joined the Company as Vice President and General Manager, JDL Technologies in December 2011.

**Non-Equity Incentive Plan Compensation Table**

The following table provides a breakdown of information under the column Non-Equity Incentive Plan Compensation in the preceding Summary Executive Compensation Table. For further information see CD&A Discussion of Executive Officer Compensation beginning at page 14.

<b><u>Name</u></b>	<b><u>Year</u></b>	<b><u>Short-Term Plans (\$)</u></b>	<b><u>Long-Term Plans (\$)</u></b>
Mr. Schultz	2012	27,042	-
	2011	213,917	60,962
	2010	146,707	56,468
Mr. McGraw	2012	18,459	-
	2011	172,864	60,476
	2010	177,670	77,594
Mr. Blackwood	2012	83,715	-
	2011	63,593	6,473
	2010	80,699	7,329
Mr. Sadura	2012	17,499	-
	2011	97,489	-
	2010	42,981	-
Mr. Fluegge	2012	3,342	-
	2011	-	-

**Other Compensation Table**

The following table provides a breakdown of information under the column Other Compensation above.

<b><u>Name</u></b>	<b><u>Year</u></b>	<b><u>Contributions to Defined Contribution Plan (1) (\$)</u></b>	<b><u>Non-Elective Contributions to CSI Defined Contribution Plan (2) (\$)</u></b>	<b><u>Other (3)</u></b>	<b><u>Total (\$)</u></b>
Mr. Schultz	2012	7,500	8,500	7,750	23,750
	2011	7,350	6,035	3,076	16,461
	2010	4,489	7,294	-	11,783
Mr. McGraw	2012	7,500	8,354	5,600	21,454
	2011	7,350	8,250	5,600	21,200
	2010	4,489	7,084	5,600	17,173
Mr. Blackwood	2012	7,500	6,718	31,154	45,372
	2011	7,350	5,633	29,600	42,583
	2010	4,489	5,952	29,600	40,041
Mr. Sadura	2012	7,357	4,708	7,750	19,815
	2011	6,628	4,503	7,750	18,881

Edgar Filing: COMMUNICATIONS SYSTEMS INC - Form DEF 14A

	2010	2,514	3,144	24,850	30,508
Mr. Fluegge	2012	-	1,936	7,942	9,878
	2011	-	-	-	-

- (1) Represents contributions for Named Executive Officers to the Company's Employee Stock Ownership Plan and Trust.
- (2) Represents the Company match of Named Executive Officers' contribution to the CSI's 401(k) Plan.
- (3) See CD&A - Other Compensation.

**Table of Contents****Outstanding Equity Awards at Fiscal Year-End**

The following table sets forth certain information concerning outstanding equity awards held by Named Executive Officers as of December 31, 2012.

<u>Name</u>	<u>Number of Securities Underlying Unexercised Options</u>		<u>Option Exercise Price</u> ( <u>\$</u> )	<u>Option Expiration Date</u>	<u>Shares or Units of Stock that have not Vested</u>		<u>Equity Incentive Plan Awards: Unearned Shares, Units or Other Rights that have not Vested</u>	
	<u>Exercisable</u> ( <u>#</u> )	<u>Unexercisable</u> ( <u>#</u> )			<u>Number</u> ( <u>#</u> )	<u>Market Value</u> ( <u>\$</u> )	<u>Number of</u> ( <u>#</u> )	<u>Market or Payout Value of</u> ( <u>\$</u> )
Mr. Schultz	3,148	9,443	14.15	3/3/2018	-	-	6,540	68,016
		34,884	13.10	2/28/2019	-	-	22,476	233,750
Mr. McGraw	3,323	9,968	14.15	3/3/2018	-	-	6,900	71,760
		18,213	13.10	2/28/2019	-	-	11,736	122,054
Mr. Blackwood	1,768	5,303	14.15	3/3/2018	-	-	3,670	38,168
		9,058	13.10	2/28/2019	-	-	5,836	60,694
Mr. Sadura	1,450	4,350	14.15	3/3/2018	-	-	3,060	31,824
		8,400	13.10	2/28/2019	-	-	5,412	56,285
Mr. Fluegge	-	7,920	13.10	2/28/2019	-	-	5,104	53,082

**Table of Contents****Grants of Plan-Based Awards in 2012**

The following table sets forth certain information concerning plan-based awards granted to the Named Executive Officers during the fiscal year ending December 31, 2012.

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards (1)		Estimated Future Payouts Under Equity Incentive Plan Awards		All Other Option Awards Number of Securities Underlying Options (#)	Exercise or Base Price of Option Awards (\$)	Grant Date Fair Value of Stock and Option Awards (\$)(2)
		Target (\$)	Maximum (\$)	Target (#)	Maximum (#)			
Mr. Schultz	3/15/2012(4)	-	-	-	-	34,884	13.10	87,210
	3/28/2012(3)	-	-	-	2,248	-	-	30,415
	3/28/2012(5)	-	-	11,238	22,476	-	-	152,050
	n/a(6)	50,873	101,745	-	-	-	-	-
	n/a(7)	203,490	299,130	-	-	-	-	-
Mr. McGraw	3/15/2012(4)	-	-	-	-	18,213	13.10	45,533
	3/28/2012(3)	-	-	-	1,537	-	-	20,796
	3/28/2012(5)	-	-	5,868	11,736	-	-	79,394
	n/a(6)	26,551	53,122	-	-	-	-	-
	n/a(7)	139,128	215,648	-	-	-	-	-
Mr. Blackwood	3/15/2012(4)	-	-	-	-	9,058	13.10	22,645
	3/28/2012(3)	-	-	-	1,042	-	-	14,098
	3/28/2012(5)	-	-	2,918	5,836	-	-	39,481
	n/a(6)	13,209	26,418	-	-	-	-	-
	n/a(7)	94,350	150,960	-	-	-	-	-
Mr. Sadura	3/15/2012(4)	-	-	-	-	8,400	13.10	21,000
	3/28/2012(3)	-	-	-	966	-	-	13,070
	3/28/2012(5)	-	-	2,706	5,412	-	-	36,612
	n/a(6)	12,250	24,500	-	-	-	-	-
	n/a(7)	87,500	140,000	-	-	-	-	-
Mr. Fluegge	3/15/2012(4)	-	-	-	-	7,920	13.10	19,800
	3/28/2012(3)	-	-	-	-	-	-	-