

PSYCHEMEDICS CORP  
Form DEF 14A  
April 08, 2013

# SCHEDULE 14A INFORMATION

## PROXY STATEMENT PURSUANT TO SECTION 14(A) OF THE SECURITIES EXCHANGE ACT OF 1934 (AMENDMENT NO. )

FILED BY THE REGISTRANT    
FILED BY A PARTY OTHER THAN THE REGISTRANT    
Check the appropriate box:

- Preliminary Proxy Statement
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to sec.240.14a-11(c) or sec.240.14a-12
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

### PSYCHEMEDICS CORPORATION

(Name of Registrant as Specified In Its Charter)

#### PAYMENT OF FILING FEE (CHECK THE APPROPRIATE BOX):

- No fee required.
  - Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.
- (1) Title of each class of securities to which transaction applies:
- (2) Aggregate number of securities to which transaction applies:

(3) 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):

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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:

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(4) Date Filed:

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**Psychemedics**  
CORPORATION

BOSTON    LOS ANGELES    CHICAGO  
DALLAS    LAS VEGAS

April 5, 2013

Dear Stockholders:

We cordially invite you to attend the Annual Meeting of Stockholders, which will be held at the Liberty Hotel, 215 Charles Street, Boston, MA 02114 on May 23, 2013, at 2:00 P.M.

Details regarding the business to be conducted are more fully described in the accompanying Notice of Annual Meeting of Stockholders and Proxy Statement. In addition, I will report on current operations and discuss our plans for growth. We will also have plenty of time for your questions and comments. I believe that the Annual Meeting provides an excellent opportunity for stockholders to become better acquainted with the Company and its directors and officers. I hope that you will be able to attend.

Your vote is important. Whether or not you plan to attend the annual meeting, I hope that you will vote as soon as possible. Please review the instructions on each of your voting options described in the Proxy Statement.

Thank you for your ongoing support of, and continued interest in, Psychemedics Corporation.

Sincerely,

Raymond C. Kubacki  
*Chairman, President and Chief Executive Officer*

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**PSYCHEMEDICS CORPORATION**  
**125 Nagog Park**  
**Acton, Massachusetts 01720**  
**978-206-8220**

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS**

April 5, 2013

The Annual Meeting of Stockholders will be held on May 23, 2013 at 2:00 P.M. at the Liberty Hotel, 215 Charles Street, Boston, MA 02114, for the following purposes:

1. To elect directors of the Company for the ensuing year and until their respective successors are chosen and qualified;
2. To conduct a non-binding advisory vote on the compensation of our named executive officers;
3. To conduct a non-binding advisory vote to determine the frequency of conducting future advisory votes on executive compensation;
4. To ratify the Audit Committee's appointment of BDO USA, LLP as the Company's independent registered public accounting firm for the year ending December 31, 2013; and
5. To consider and act upon matters incidental to the foregoing and to transact such other business as may properly come before the Annual Meeting.

The Board of Directors has fixed the close of business on March 25, 2013 as the record date for the determination of stockholders entitled to receive notice of, and to vote at, the Annual Meeting of Stockholders.

*Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to be Held on May 23, 2013:* We have elected to provide access to our proxy materials by: (i) sending you this full set of proxy materials, including the proxy statement, our Annual Report for 2012, and a proxy card; and (ii) notifying you of the availability of these proxy materials on the Internet that you may download and print by going to [www.psychemedics.com/proxy](http://www.psychemedics.com/proxy).

We encourage you to review all of the important information contained in the proxy materials contained herein or accessed on our website at [www.psychemedics.com/proxy](http://www.psychemedics.com/proxy) before voting.

By order of the Board of Directors,  
Edward S. Brewer, Jr.,  
*Secretary*

The Company's Annual Report for 2012 containing a copy of the Company's Form 10-K (excluding exhibits) for the year ended December 31, 2012 is enclosed herewith.

**Please fill in, date, sign and mail promptly the accompanying proxy in the return envelope furnished for that purpose, whether or not you plan to attend the Annual Meeting.**

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**PSYCHEMEDICS CORPORATION**  
**125 Nagog Park**  
**Acton, Massachusetts 01720**

**PROXY STATEMENT**

**ANNUAL MEETING OF STOCKHOLDERS  
TO BE HELD ON MAY 23, 2013**

You are receiving this communication because you hold shares in PSYCHEMEDICS CORPORATION (hereinafter, the Company ). We have elected to provide access to our proxy materials by: (i) sending you this full set of proxy materials, including the proxy statement, our Annual Report for the year ended December 31, 2012, and a proxy card; and (ii) notifying you of the availability of these proxy materials on the internet that you may download and print by viewing [www.psychemedics.com/proxy](http://www.psychemedics.com/proxy). We encourage you to review all of the important information contained in the proxy materials contained herein or accessed on our website at [www.psychemedics.com/proxy](http://www.psychemedics.com/proxy) before voting.

This statement is furnished to the stockholders of the Company in connection with management's solicitation of proxies to be used at the Annual Meeting of Stockholders on May 23, 2013 and at any adjournment of that meeting. The approximate date on which this proxy statement and accompanying proxy are being sent to stockholders of the Company is April 5, 2013. Each proxy delivered pursuant to this solicitation, or any proxy that you may download from [www.psychemedics.com/proxy](http://www.psychemedics.com/proxy), is revocable at the option of the person executing the same by written notice delivered to the Secretary of the Company at any time before the proxy is voted. A stockholder who attends the Annual Meeting in person may revoke his or her proxy at that time and vote his or her shares if such stockholder so desires.

Most stockholders of the Company hold their shares through a stockbroker, bank, trustee or other nominee rather than directly in their own name. As summarized below, there are some distinctions between shares held of record and those owned beneficially.

*Stockholders of Record.* If your shares are registered directly in your name with the Company's transfer agent, ComputerShare, you are considered the stockholder of record of those shares and these proxy materials are being sent directly to you by the Company. As the stockholder of record, you have the right to grant your voting proxy directly to the Company or to vote in person at the Annual Meeting.

*Beneficial Owner.* If your shares are held in a stock brokerage account, by a bank, trustee or other nominee, you are considered the beneficial owner of shares held in street name and these proxy materials are being forwarded to you by your broker, trustee or nominee who is considered the stockholder of record of those shares. As the beneficial owner, you have the right to direct your broker, trustee or nominee on how to vote and are also invited to attend the Annual Meeting. However, since you are not the stockholder of record, you may not vote these shares in person at the Annual Meeting. Your broker, trustee or nominee is obligated to provide you with a voting instruction card for you to use.

The presence in person or by proxy of stockholders entitled to cast a majority of the outstanding shares, or 2,636,793 shares, shall constitute a quorum. Under Nasdaq rules, if your broker holds your shares in its name and does not receive voting instructions from you, your broker has discretion to vote these shares on certain routine matters, including the ratification of the Audit Committee's appointment of BDO USA, LLP as the Company's independent registered public accounting firm. However, on non-routine matters such as the election of directors, or the non-binding advisory votes concerning executive compensation, your broker must receive voting instructions from you, as it does not have discretionary voting power for these particular items. So long as the broker has discretion to vote on at least one proposal, these broker non-votes are counted toward establishing a quorum. When voted on routine matters, broker non-votes are counted toward determining the outcome of that routine matter. With respect to the election of Directors, the Company will treat votes withheld as shares that are present for purposes of determining a quorum. A plurality is required to elect Directors, so the four persons receiving the greatest number of votes will be elected. Withheld votes will not affect the outcome of the election. With respect to the ratification of the Audit Committee's appointment of BDO USA, LLP, or the vote, on an advisory and non-binding basis, of the compensation of the Company's

named executive officers, the Company will treat abstentions as shares that are present and entitled to vote. Since a majority of the shares represented at the meeting and entitled to vote is required for approval, abstentions will have the effect of a vote against approval of these proposals. With respect to the non-binding advisory vote regarding how frequently the Company should seek from its shareholders a non-binding advisory vote on executive compensation, since a plurality of votes cast will be used to determine the results of the non-binding advisory vote, the Company will treat abstentions as having no effect on such matter. If a broker indicates on a proxy that it does not have discretionary authority as to certain shares to vote on a particular matter, those shares will not be considered as shares entitled to vote with respect to that matter. Accordingly, broker non-votes will have no effect on such a matter.

All shares represented by a properly executed proxy will be voted unless the proxy is revoked and, if a choice is specified, will be voted in accordance with such specification. If no choice is specified, the proxies will be voted FOR the election of the four nominees named under Election of Directors , unless authority to do so is withheld with respect to one or more of the nominees, FOR the approval, on an advisory and non-binding basis, of the compensation of the Company's named executive officers, FOR the every three years option for the frequency, on an advisory and non-binding basis, of future advisory votes on executive compensation, and FOR the ratification of the Audit Committee s appointment of BDO USA, LLP for the year ending December 31, 2013 In addition, the proxy will be voted in the discretion of the proxy holders with respect to such other business as may properly come before the Annual Meeting.

As of March 25, 2013, the Company had outstanding 5,273,585 shares of Common Stock. The Common Stock is the only type of security entitled to vote at the Annual Meeting. Each share of Common Stock entitles the holder of record thereof at the close of business on March 25, 2013 to one vote on each of the matters to be voted upon at the Annual Meeting.

## ELECTION OF DIRECTORS

At the Annual Meeting, directors are to be elected to hold office for the ensuing year and until their respective successors are chosen and qualified. The Board of Directors has fixed the size of the Board at four and has nominated four persons, all of whom are now directors of the Company, to serve until the next Annual Meeting of Stockholders and until their successors are elected and qualified. If the enclosed proxy, or any proxy that you may download from [www.psychemedics.com/proxy](http://www.psychemedics.com/proxy) is duly executed and received in time for the Annual Meeting, and unless authority to do so is withheld, it will be voted to elect as directors the following nominees: Raymond C. Kubacki, Harry Connick, Walter S. Tomenson, Jr. and Fred J. Weinert. In the event that any of the nominees becomes unavailable, then the proxy holders shall have the right: (i) to vote for such substitute, if any, as the present Board of Directors may designate; or (ii) to leave a vacancy on the Board.



## BUSINESS EXPERIENCE OF NOMINEES AND EXECUTIVE OFFICERS

Following is a list of names, ages and positions with the Company of all nominees for election as directors and all executive officers of the Company.

Name	Age	Position
Raymond C. Kubacki	68	Chairman of the Board, Chief Executive Officer, President, Director and Nominee
Harry Connick	87	Director and Nominee, Member of Audit, Nominating and Compensation Committees
Walter S. Tomenson, Jr.	66	Director and Nominee, Member of Audit, Nominating and Compensation Committees
Fred J. Weinert	65	Director and Nominee, Member of Audit, Nominating and Compensation Committees
Michael I. Schaffer, Ph.D.	68	Vice President, Laboratory Operations
James V. Dyke	48	Corporate Vice President, Sales and Marketing
Neil Lerner	45	Vice President Finance

All directors hold office until the next Annual Meeting of Stockholders or until their successors are elected. Officers serve at the discretion of the Board of Directors.

Mr. Kubacki has been the Company's President and Chief Executive Officer since 1991. He has also served as Chairman of the Board of the Company since 2003. He is a director of Integrated Environmental Technologies, LTD. From 2007 until 2010, he served as a director of Protection One, Inc. and from 2004 to 2007 he served as a director of Integrated Alarm Services Group, Inc. He is also a trustee of the Center for Excellence in Education based in Washington, D.C. and holds an Executive Masters Professional Director Certification, their highest level award, from the American College of Corporate Directors, a public company director education and credentialing organization. As a result of these and other professional experiences, Mr. Kubacki possesses particular knowledge and experience in marketing and operations that strengthen the Board's collective qualifications, skills and experience. Mr. Kubacki has been a director of the Company since 1991.

Mr. Connick served as District Attorney for Orleans Parish (New Orleans, LA) from 1974 to 2003. In 2002, Mr. Connick received from Drug Czar, John P. Walters, the Director's Award for Distinguished Service in recognition of exemplary accomplishment and distinguished service in the fight against illegal drugs. As a result of these and other professional experiences, Mr. Connick possesses particular knowledge and experience in law enforcement and the effects of drugs of abuse and their effect on society that strengthen the Board's collective qualifications, skills and experience. Mr. Connick has been a director of the Company since 2003.

Mr. Tomenson is a Senior Advisor to Integro Ltd. Mr. Tomenson was Managing Director and Chairman of Client Development of Marsh, Inc. from 1998 until 2004. From 1993 to 1998, he was chairman of FINPRO, the financial services division of Marsh, Inc. Mr. Tomenson is a Director of the Trinity College School Fund, Inc. He also serves on the Executive Council of the Inner-City Scholarship Fund and holds an Executive Masters Professional Director Certification, their highest level award, from the American College of Corporate Directors, a public company director education and credentialing organization. As a result of these and other professional experiences, Mr. Tomenson possesses particular knowledge and experience in marketing and distribution and human resources that strengthen the Board's collective qualifications, skills and experience. Mr. Tomenson has been a director of the Company since 1999.

Mr. Weinert is an entrepreneur whose current activities are concentrated in commercial real estate, new business development and environmental consulting. He has served on the Business Advisory Council for the University of Dayton for over 20 years. From 1973 until 1989, Mr. Weinert held various executive positions in the Finance and Operations groups of Waste Management, Inc. and its subsidiaries, including 6 years as the President of Waste Management International, Inc. As a result of these and other professional experiences, Mr. Weinert possesses particular knowledge and experience in accounting, finance, capital structures, distribution and international operations that strengthen the Board's collective qualifications, skills and experience. Mr. Weinert has been a director of the Company since 1991.

Dr. Schaffer has served as Vice President of Laboratory Operations since 1999. From 1990 to 1999, he served as Director of Toxicology, Technical Manager and Responsible Person for the Leesburg, Florida laboratory of SmithKline Beecham Clinical Laboratories. From 1990 to 1999, he was also a member of the Board of Directors of the American Board of Forensic Toxicologists. Dr. Schaffer has been an inspector for the Substance Abuse and Mental Health Services Administration's National Laboratory Certification Program since 1989.

Mr. Dyke joined the Company in 2010 and currently serves as the Corporate VP of Sales and Marketing. He has 25 years of international experience working in Canada, the United Kingdom and the United States in a variety of senior management, sales and marketing roles. Prior to joining the Company, he worked as a Strategic Sales Consultant and served as Vice President of Sales & Marketing with Pitney Bowes Inc.

Mr. Lerner joined the Company in 2010 and currently serves as the Vice President of Finance and Treasurer. From October, 2010 until May, 2011 he served as Vice President and Controller of the Company. Prior to joining the Company, he served as Director of Operational Accounting at Beacon Roofing Supply, Inc., Corporate Controller with Atlas TMS, Divisional Controller with Mastec, Inc, and multiple roles with Johnson & Johnson, including plant controller in the Netherlands. Mr. Lerner is a Certified Public Accountant and holds a Masters degree in International Management.

## CORPORATE GOVERNANCE

### General

The Company believes that good corporate governance is important to ensure that the Company is managed for the long-term benefit of its stockholders. The Board of Directors of the Company has responsibility for establishing broad corporate policies and reviewing the overall performance of the Company. The Company's officers are responsible for day-to-day operations. The Board's primary responsibility is to oversee the management of the Company and, in so doing, serve the best interests of the Company and its stockholders. The Board selects, evaluates and provides for the succession of executive officers and, subject to stockholder election, directors. It reviews and approves corporate objectives and strategies, and evaluates significant policies and proposed major commitments of corporate resources. It participates in decisions that have a potential major economic impact on the Company. Management keeps the directors informed of Company activity through regular reports and presentations at Board and committee meetings.

The Board of Directors has delegated certain of its oversight responsibilities to three separate subcommittees: an Audit Committee, a Compensation Committee and a Nominating Committee, each of which is comprised solely of independent directors (see Independence below). The Audit Committee operates under an Audit Committee charter and the Nominating Committee operates under a Nominating Committee charter, each of which has been approved by the Board of Directors of the Company and is posted on the Company's web site at [psychemedics.com](http://psychemedics.com). Each committee must review the appropriateness of its charter and perform a self-evaluation at least annually. Mr. Kubacki is the only director who is also an employee of the Company. He is not included in deliberations concerning evaluation of his own compensation at any meetings of the Compensation Committee. All members of all committees are non-employee directors.

The Company has in place a comprehensive Code of Ethics and Conduct. You may obtain a copy of the Company's Code of Ethics and Conduct by writing to the Company at Investor Relations, Psychemedics Corporation, 125 Nagog Park, Acton, Massachusetts 01720, or by viewing the Investor Information section of the Company's website at [www.psychemedics.com](http://www.psychemedics.com).

## Independence

Under the rules of the Nasdaq Stock Market, a majority of the directors and all of the members of the Audit Committee must qualify as independent directors. The Board of Directors of the Company conducts an annual review of the independence of the members of the Board and its committees. Three of our four directors are nonemployee directors (all except Mr. Kubacki). Although the Board has not adopted categorical standards of materiality for independence purposes (other than those set forth in the Nasdaq Stock Market listing standards), information provided by the directors and the Company did not indicate any relationships (e.g., commercial, industrial, banking, consulting, legal, accounting, charitable, or familial), which would impair the independence of any of the nonemployee directors.

4

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## **Certain Relationships and Related Transactions**

The Board of Directors has adopted a policy whereby the Company's Audit Committee is responsible for reviewing any proposed related party transaction. The types of transactions covered by the policy include payments for products or services to or indebtedness to or from, related parties, as defined in Item 404(b) of Regulation S-K under the federal securities laws. The Audit Committee has determined that there were no related party transactions with any related party in fiscal 2012 that would require disclosure under Item 404(a) of Regulation S-K.

## **Board of Directors Meetings and Committees**

The Board of Directors met six times in fiscal year 2012 (including teleconference meetings). In addition, the directors acted by unanimous written consent in lieu of meetings on three occasions during 2012. During fiscal year 2012, each of the directors attended at least 75% of the total number of meetings of the Board of Directors and the committees of which such director was a member.

The Company encourages all incumbent directors, as well as all nominees for election as director, to attend the Annual Meeting of Stockholders. All of the Company's directors attended the Company's Annual Meeting in May, 2012.

### **Audit Committee**

The Audit Committee, whose members are Messrs. Connick, Tomenson and Weinert, reviews the appropriateness, quality and acceptability of the Company's accounting policies and the integrity of financial statements reported to the public, and compliance with legal and regulatory requirements. The Board has determined that each member of the Audit Committee satisfies the requirements of the Nasdaq Stock Market regarding competency in financial matters. In addition, the Board of Directors has determined that Mr. Weinert, the Chairman of the Audit Committee, qualifies as an Audit Committee Financial Expert as defined by the Securities and Exchange Commission rules. None of Messrs. Connick, Tomenson or Weinert serves on the audit committees of any other public company. The responsibilities of the Audit Committee and its activities during fiscal year 2012 are described in the Report of the Audit Committee set forth below in this proxy statement.

### **Compensation Committee**

The Compensation Committee, whose members are Messrs. Connick, Tomenson and Weinert, held two meetings during 2012. In addition, the members of the Compensation Committee acted by unanimous written consent in lieu of a meeting on one occasion during 2012. The Compensation Committee does not have a charter. The responsibilities of the Compensation Committee and its activities during fiscal year 2012 are described below under the caption Executive Compensation .

### **Compensation Committee Interlocks and Insider Participation**

None of Messrs. Connick, Tomenson or Weinert has ever been an officer or employee of the Company or any subsidiary of the Company and no executive officer of the Company serves on the board of directors of any company at which any of the Compensation Committee members is employed.

### **Nominating Committee**

The Nominating Committee, whose members are Messrs. Connick, Tomenson and Weinert, held one meeting during 2012. The Nominating Committee is charged with identifying and screening candidates, consistent with criteria approved by the Board of Directors, and making recommendations to the Board of Directors as to persons to be nominated by the Board of Directors for election thereto by the stockholders or to be chosen by the Board of Directors to fill newly created directorships or vacancies on the Board of Directors. The Board of Directors has determined that each of the members of the Nominating Committee is independent as defined in the Nasdaq Stock Market's listing standards.

The Nominating Committee identifies Board candidates through numerous sources, including recommendations from Directors, executive officers and stockholders of the Company. The Nominating Committee evaluates identified Board candidates based on the criteria established by and periodically reviewed by the Nominating Committee. The Nominating Committee seeks to identify those individuals most qualified to serve as Board members and will consider many factors with regard to each candidate, including judgment,

integrity, diversity, prior experience, the interplay of the candidate's experience with the experience of other Board members, the extent to which the candidate would be desirable as a member of any committees of the Board, and the candidate's willingness to devote the time and effort required for Board responsibilities. Selected candidates are interviewed by members of the Nominating Committee and certain other Board members. Based on the foregoing, the Nominating Committee makes recommendations to the Board with respect to director nominees.

The Company's stockholders may recommend individuals to the Nominating Committee for consideration as potential director candidates at the Company's 2014 Annual Meeting by submitting their names and appropriate background and biographical information to the Company's Nominating Committee, Psychemedics Corporation, 125 Nagog Park, Acton, Massachusetts 01720 not later than December 7, 2013. Assuming that the appropriate information has been timely provided, the Nominating Committee will consider these candidates substantially in the same manner as it considers other Board candidates it identifies.

## **Board Leadership Structure, Risk Oversight, Executive Sessions of Nonemployee Directors, and Communications Between Stockholders and the Board**

### **Board Leadership Structure**

As noted above, our Board is currently comprised of three independent directors and one employee director. Mr. Kubacki has served as Chairman of the Board since 2003, and he has served as Chief Executive Officer and as a member of our Board since 1991. We believe that our independent, experienced directors, who constitute a majority of our Board, benefit Psychemedics and its stockholders.

We recognize that different board leadership structures may be appropriate for companies in different situations and believe that no one structure is suitable for all companies. We believe our current Board leadership structure is optimal for us because it demonstrates to our employees, suppliers, customers, and other stakeholders that Psychemedics is under strong leadership, with a single person setting the tone and having primary responsibility for managing our operations. Having a single leader for both the company and the Board eliminates the potential for confusion or duplication of efforts, and provides clear leadership for Psychemedics. We believe Psychemedics, like many U.S. companies, has been well-served by this leadership structure.

As part of an annual self evaluation, our Board of Directors conducts an evaluation in order to determine whether it and its committees are functioning effectively. As part of this annual self-evaluation, the Board evaluates whether the current leadership structure continues to be optimal for Psychemedics and its stockholders. When making recommendations of future Board candidates, our Nominating Committee, under the authority vested in it under our Nominating Committee Charter, is provided flexibility to modify or continue our leadership structure in the future, as it deems appropriate.

### **Risk Oversight**

Our Board is responsible for overseeing the Company's risk management process. The Board focuses on Psychemedics general risk management strategy, the most significant risks facing Psychemedics, and ensures that appropriate risk mitigation strategies are implemented by management. The Board is also apprised of particular risk management matters in connection with its general oversight and approval of corporate matters.

The Board has delegated to the Audit Committee oversight of Psychemedics' risk management process. Among its duties, the Audit Committee reviews with management (a) Psychemedics' policies with respect to risk assessment and management of risks that may be material to Psychemedics, (b) Psychemedics' system of disclosure controls and system of internal controls over financial reporting, and (c) Psychemedics' compliance with legal and regulatory requirements. The Audit Committee is also responsible for reviewing major legislative and regulatory developments that could materially impact Psychemedics' contingent liabilities and risks. Our full Board also considers and addresses risk as it performs its responsibilities. All committees report to the full Board as appropriate, including when a matter rises to the level of a material or enterprise level risk.



Psychemedics management is responsible for day-to-day risk management. Our Vice President Finance undertakes primary responsibility for monitoring and testing for company-wide policies and procedures, and manages the day-to-day oversight of the risk management strategy for the ongoing business of Psychemedics. This oversight includes identifying, evaluating, and addressing potential risks that may exist at the enterprise, strategic, financial, operational, and compliance and reporting levels.

We believe the division of risk management responsibilities described above is an effective approach for addressing the risks facing Psychemedics and that our Board leadership structure supports this approach.

### **Executive Sessions of Nonemployee Directors**

The Board holds executive sessions of its nonemployee directors generally at each regularly scheduled meeting. The Chairman of the Audit Committee serves as the chairperson for these executive sessions.

### **Communications between Stockholders and the Board**

Interested parties, including stockholders, may communicate directly with the Chairman of the Audit Committee or the nonemployee directors as a group by writing to those individuals or the group at the following address: Psychemedics Corporation, 125 Nagog Park, Acton, Massachusetts 01720. If correspondence is received by the Corporate Secretary, it will be forwarded to the appropriate person or persons in accordance with the procedures adopted by a majority of the independent directors of the Board. When reporting a concern, please supply sufficient information so that the matter may be addressed properly. Although you are encouraged to identify yourself to assist Psychemedics in effectively addressing your concern, you may choose to remain anonymous, and Psychemedics will use its reasonable efforts to protect your identity to the extent appropriate or permitted by law.

## **Report of the Audit Committee**

The Audit Committee of the Board of Directors is responsible for providing independent, objective oversight of the Company's accounting functions and internal controls. Management has the primary responsibility for the financial statements and the reporting process, including the system of internal controls. The Audit Committee oversees the financial reporting process on behalf of the Board of Directors, reviews financial disclosures, and meets privately, outside the presence of management, with the independent auditors to discuss internal accounting control policies and procedures. In fulfilling its oversight responsibilities, the Audit Committee reviews the audited financial statements in the Annual Report on Form 10-K with management including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments, and the clarity of disclosures in the financial statements. The Audit Committee reports on these meetings to the Board of Directors. The Audit Committee also selects and appoints the independent auditors, reviews the performance of the independent auditors in the annual audit and in assignments unrelated to the audit, and pre-approves the independent auditors' services. The Audit Committee operates under a written charter adopted by the Board of Directors, a copy of which can be viewed on the Company's website under Corporate Governance .

The Audit Committee is composed of three non-employee directors, Messrs. Connick, Tomenson and Weinert, each of whom is an independent director under the rules of the Nasdaq Stock Market governing the qualifications of the members of audit committees. The Audit Committee held four meetings during 2012. Mr. Weinert qualifies as an Audit Committee Financial Expert under the rules of the Securities and Exchange Commission. In addition, the Board of Directors has determined that each member of the Audit Committee meets the minimum standards regarding competency in financial matters required under the rules of the Nasdaq Stock Market. None of Messrs. Connick, Tomenson and Weinert serves on the audit committee of any other public company.

The Audit Committee reviewed with the independent auditors their judgments as to the quality, not just the acceptability, of accounting principles and such other matters as are required to be discussed with the Audit Committee under the standards of the Public Company Accounting Oversight Board (United States) (the PCAOB ). In addition, the Audit Committee has received the written disclosures and the letter from the independent auditors required by the PCAOB Rule 3526, and has discussed with the independent auditors the independence of the independent auditors. The Audit Committee considered and determined that the provision of non-audit services by BDO USA, LLP was compatible with maintaining auditor independence.

7

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Based on its review and discussions, the Audit Committee recommended to the Board of Directors that the audited financial statements be included in the Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Members of the Audit Committee:

*Harry Connick*  
*Walter S. Tomenson, Jr.*  
*Fred J. Weinert*

## **Fees Paid to the Independent Registered Public Accounting Firm**

The following table presents fees paid or payable to BDO USA, LLP for services attributable to fiscal years 2012 and 2011:

	Fiscal Year 2012	Fiscal Year 2011
Audit Fees <sup>(1)</sup>	\$ 174,410	\$ 176,330
Audit-Related Fees <sup>(2)</sup>	13,050	13,025
Tax Fees <sup>(3)</sup>	24,000	25,350
Total	\$ 211,460	\$ 214,705

(1) **Audit Fees** Fees for professional services rendered to the Company (or estimates of fees for services to be rendered) in connection with auditing the Company's annual financial statements and reviewing the interim financial information included in the Company's Quarterly Reports on Form 10-Q, and consents and assistance with the review of documents filed with the Securities and Exchange Commission.

(2) **Audit-Related Fees** Fees billed to the Company or to the Company's employee retirement plan for services related to the audit of the Company's financial statements, that are not reported under Audit Fees, which include audit work performed on certain of the Company's benefit plans.

(3) **Tax Fees** Fees billed to the Company related to tax compliance and consultation.

## **Audit Committee Pre-Approval Policy of Audit and Permissible Non-Audit Services of Independent Registered Public Accounting Firm**

The Audit Committee's policy is to pre-approve all audit and permissible non-audit services provided by the Company's independent registered public accounting firm. These services may include audit services, audit-related services, tax services and other services. Any pre-approval is detailed as to the particular service or category of services and is generally subject to a specific budget. The Audit Committee may delegate pre-approval authority to one or more of its members when expedition of services is necessary. The independent registered public accounting firm and management are required to periodically report to the full Audit Committee regarding the extent of services provided, in accordance with this pre-approval policy, and the fees for the services performed to date.

## Director Compensation

Mr. Kubacki receives no additional compensation for serving on the Company's Board of Directors. Each of the Company's outside (non-employee) directors received cash compensation of \$40,000 in 2012. In addition, Mr. Weinert, the Chairman of the Audit Committee, received additional cash compensation of \$10,000 in 2012. Each of the outside directors has also been granted from time to time equity awards under the Company's equity compensation plans, most recently in May, 2012, when each outside director was granted 4,000 stock unit awards under the Company's 2006 Incentive Plan, each such stock unit award representing the right to receive one share of Common Stock of the Company. Each such award vests with respect to 50% of the shares covered thereby on April 30, 2013 and with respect to the balance of the shares on April 30, 2014, in each case, so long as the recipient remains in continuous service as a member of the Board of Directors of the Company through each such vesting date. Any unvested stock unit awards terminate upon the cessation of a recipient's service as a member of the Board of Directors, subject to partial vesting in the case of termination on account of death or permanent disability. In the event of a change in control of the Company (as defined in the stock unit award agreement evidencing the award) the stock unit awards become fully vested immediately prior to the effective date of such change in control.

The following table shows, for the fiscal year ended December 31, 2012, the compensation paid by the Company or accrued for such year, to the Company's non-employee directors. The compensation paid to Mr. Kubacki for his service as Chairman, Chief Executive Officer and President, is reported in the Summary Compensation Table under the caption Executive Compensation below.

## Director Compensation For Fiscal Year Ended December 31, 2012

(a) Name	(b) Fees Earned or Paid in Cash (\$)	(c) Stock Awards (\$) <sup>(1)</sup>	(d) Option Awards (\$) <sup>(3)</sup>	(e) Non-Equity Incentive Plan Compensation (\$)	(f) Non-qualified Deferred Compensation Earnings (\$)	(g) All other Compensation (\$) <sup>(4)</sup>	(h) Total (\$)
Harry Connick	40,000	39,160 <sup>(2)</sup>					79,160
Walter Tomenson, Jr.	40,000	39,160 <sup>(2)</sup>					79,160
Fred J. Weinert	50,000	39,160 <sup>(2)</sup>					89,160

(1) The amounts in column (c) reflect the grant date fair value of awards to the named individuals in 2012.

(2) Each such award vested with respect to 50% of the shares covered thereby on April 30, 2013 and the balance of the shares vest on April 30, 2014. As of December 31, 2012, each director had 5,850 of unvested stock unit awards.

(3) As of December 31, 2012, the directors held the following number of unexercised options to acquire Common Stock: Mr. Connick: 16,738; Mr. Tomenson: 20,650; and Mr. Weinert: 18,650.

(4) Any perquisites or other personal benefits received from the Company by the named director were less than the reporting thresholds established by the Securities and Exchange Commission (\$10,000).

# **EXECUTIVE COMPENSATION**

## **Overview of Compensation Program**

The Compensation Committee of the Board has responsibility for establishing, implementing and continually monitoring adherence to the Company's compensation philosophy. The Compensation Committee ensures that the total compensation paid to the executive officers is fair, reasonable and competitive.

Throughout this proxy statement, the individual who served as the Company's Chief Executive Officer during fiscal 2012, as well as the other individuals included in the Summary Compensation Table on page 13, are referred to as the named executive officers (NEOs).

## **Compensation Philosophy and Objectives**

The Compensation Committee believes that the most effective executive compensation program is one that is designed to reward the achievement of specific annual performance goals by the Company, and which aligns executives' interests with those of the stockholders by rewarding performance with the ultimate objective of improving stockholder value. The Compensation Committee evaluates both performance and compensation to ensure that the Company maintains its ability to attract and retain superior employees in key positions and that compensation provided to key employees remains competitive relative to the compensation paid to similarly situated executives of similarly sized public companies. To that end, the Compensation Committee believes executive compensation packages provided by the Company to its executives, including the named executive officers, should include both cash and stock-based compensation and that its executives' performance should be rewarded as measured against established goals.

## **Role of Executive Officers in Compensation Decisions**

The Compensation Committee makes all compensation decisions for the Chief Executive Officer, but takes into account his recommendations when making compensation decisions with respect to the other executive officers.

The Chief Executive Officer annually reviews the performance of each other executive officer. The conclusions reached and recommendations based on these reviews, including with respect to salary adjustments and annual award amounts, are presented to the Compensation Committee. The Compensation Committee can exercise its discretion in modifying any recommended adjustments or awards to executives.

## **Setting Executive Compensation**

Based on the foregoing objectives, the Compensation Committee has structured the Company's annual and long-term incentive-based cash and non-cash executive compensation to motivate executives to achieve the business goals set by the Company and reward the executives for achieving such goals.

In making compensation decisions, the Compensation Committee compares each element of total compensation against what the Compensation Committee believes to be the average amount paid to similarly situated executives at comparably sized publicly-traded and privately-held companies.

A significant percentage of total compensation is allocated to incentives as a result of the philosophy mentioned above. The Compensation Committee determines the appropriate level and mix of incentive compensation. Income from such incentive compensation is realized as a result of the performance of the Company or the individual, depending on the type of award, compared to established goals. A significant portion of its total compensation payable to executive officers is in the form of cash bonus awards tied to achievement of performance goals and to the award of restricted stock units that would become vested over a period of time.

## 2012 Executive Compensation Components

For the fiscal year ended December 31, 2012, the principal components of compensation for named executive officers were:

base salary  
performance-based cash incentive compensation; and  
long-term equity incentive compensation  
**Base Salary**

Base salary ranges for named executive officers are determined for each executive based on his or her position and responsibility, a market competitive assessment of similar roles at other companies and a comparison of salaries paid to peers within the Company. Salary levels are typically considered annually as part of the Company's performance review process as well as upon a promotion or other change in job responsibility. Merit based increases to salaries of executive officers are based on the Compensation Committee's assessment of the individual's performance.

### Incentive Cash Bonus Compensation

The Company typically provides its named executive officers with the opportunity to earn cash incentive bonuses. For most years, bonuses are determined based on a combination of qualitative and quantitative, company and individual measures, the details of which are established annually in the form of business objectives. The business objectives may vary for each executive based upon his or her responsibilities and may include financial and/or strategic measures. The Compensation Committee typically retains the discretion to amend the bonus program including the ability to increase or decrease any bonus payment and make changes to any financial and/or strategic measures. In both 2011 and 2012, the named executive officers' bonuses were computed as follows: (i) up to ten percent (10%) of base salary would be payable if the Company achieved pre-determined revenue and earnings per share targets; (ii) up to an additional ten percent (10%) of base salary would be payable based on achievement of individual written performance objectives for the fiscal year, as determined by Mr. Kubacki (for named executive officers other than himself) and as determined by the Compensation Committee (with respect to achievement of the bonus award by Mr. Kubacki), and (iii) up to an additional five percent (5%) of base salary would be payable if certain new product launches are implemented according to plan. The Compensation Committee retained sole discretion over all matters relating to the annual bonus payments, including, without limitation, the decision to pay any bonuses, the amount of each bonus, if any, the ability to increase or decrease any bonus payment and make changes to any financial and/or strategic measures. A similar arrangement is in place for 2013, using performance objectives based on the Company's 2013 budget, and the final five percent component is based is a new product component.

### Long-Term Equity Incentive Compensation

It is the philosophy of the Company to provide executives with incentives to receive equity in the Company and, thus, align their financial interests with those of the Company's shareholders. The Company's 2006 Incentive Plan provides long-term rewards and incentives to the Company's named executive officers, as well as other participants. The 2006 Incentive Plan permits, in addition to cash-based awards, the grant of options, restricted stock, stock bonus awards, and other stock-based awards that may be denominated or payable in, valued in whole or in part by reference to or otherwise based on the Common Stock, including, but not limited to performance units, stock appreciation rights, restricted stock units or dividend equivalents, each of which may be subject to certain vesting requirements or to the attainment of certain pre-established performance goals.



**Stock Unit Awards.**

The Compensation Committee of the Company's Board of Directors has typically granted annual equity awards in the form of stock unit awards ( Awards ) to most of its executive officers. The Awards represent a right to receive shares of the Company's Common Stock in varying amounts subject to satisfaction of certain time-based vesting requirements.

The amount of stock unit awards granted to the named executive officers varies based upon their levels of responsibility, their individual performance and the Company's performance for the year preceding the year of grant.

Each of the units provides for vesting over the four-year period following the date of grant and are convertible into shares of Common Stock of the Company upon vesting.

### **Stock Options.**

Certain named executive officers continue to hold stock options granted in prior years under the Company's 2000 Stock Option Plan which was discontinued in connection with the adoption of the 2006 Incentive Plan. The stock options allow the named executive officers, as well as other key employees, the right to acquire shares of Company stock at a price equal to the fair market value of the Company's stock on the date of grant. The stock options are subject to various vesting periods ranging from zero to four years. No stock options were granted to the named executive officers in 2012.

### **Retirement and Other Benefits**

The Company maintains a 401(k) profit sharing plan for the benefit of all employees who have satisfied minimum age requirements. Employees have the opportunity to contribute to the plan on a before tax basis, subject to limits prescribed under the Internal Revenue Code. The Company has typically matched up to 50% of the first 6% of pay that has been contributed to the plan, subject to limits prescribed for highly compensated employees. All employee contributions to the 401(k) plan are fully vested upon contribution. If a matching contribution is made, it would vest ratably over a five year period. The Company does not maintain any separate non-qualified retirement plans.

### **Perquisites and Other Personal Benefits**

Any perquisites or other personal benefits that the Company offers to its executive officers are below the threshold limit (\$10,000 per executive, per annum) for reporting under SEC rules.

The Company has entered into Change of Control Severance Agreements with Messrs. Kubacki, Schaffer, and Dyke. The Change of Control Severance Agreements are designed to promote stability and continuity of senior management. Information regarding applicable payments under such agreements for Messrs. Kubacki, Schaffer and Dyke is provided under the heading "Potential Payments upon Termination or Change in Control" on page 14.

## **Tax and Accounting Implications**

### **Deductibility of Executive Compensation**

As part of its role, the Compensation Committee reviews and considers the deductibility of executive compensation under Section 162(m) of the Internal Revenue Code, which provides that the Company may not deduct compensation of more than \$1,000,000 per year to named executive officers except to the extent it constitutes performance-based compensation. The Company believes that all compensation paid to its executive officers is, or will be when paid, fully deductible for federal income tax purposes.

### **Nonqualified Deferred Compensation**

On October 22, 2004, the American Jobs Creation Act of 2004 was signed into law, changing the tax rules applicable to nonqualified deferred compensation arrangements. The Company believes it is operating in good faith compliance with the statutory provisions.

## Summary of Cash and Certain Other Compensation

The following tables show, for the fiscal year ended December 31, 2012, and 2011, the total compensation earned by the Company's Chief Executive Officer, as the Company's principal executive officer, and the Company's two most highly compensated executive officers other than the Chief Executive Officer (collectively the named executive officers) and outstanding equity awards held by them as of December 31, 2012.

### Summary Compensation Table

The amounts in column (d) reflect cash bonus awards made to the executive officers based on achievement of (1) certain financial and individual objectives, as described in more detail on page 11 under the heading Incentive Cash Bonus Compensation.

The amounts in column (e) reflect the grant date fair value of the awards with respect to stock unit awards granted (2) in the applicable year. The awards granted in 2012 become vested with respect to 25% of the shares covered thereby on the first anniversary date of the date of grant, and with respect to an additional 25% of the shares covered thereby on each of the three anniversary dates thereafter.

The amounts in column (f) reflect the grant date fair value of the awards with respect to stock options granted in (3) the applicable year, measured in accordance with ASC 718. No stock options were granted to any of the named executive officers in either 2011 or 2012.

(4) The amounts in column (g) represent commissions paid to the named executive officer.

The amount shown in column (i) reflects for each named executive officer matching contributions allocated by the (5) Company to each of the named executive officers during the applicable year pursuant to the Company's 401(k) Plan (which is more fully described on page 12 under the heading Retirement and Other Benefits); the amount of perquisites attributable to each named executive officer did not exceed \$10,000 in either 2011 or 2012.

13

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## Outstanding Equity Awards at Fiscal Year-End

- (1) Based on closing price of \$10.75 per share on December 31, 2012 on the Nasdaq Stock Market. Consists of: 15,000 shares of the stock unit award granted in April, 2010, of which 7,500 shares will vest in April, 2013 and 7,500 shares will vest in April, 2014; 14,250 of the shares of the stock unit award granted in May, 2011, of which 4,750 shares will vest in May, 2013, 4,750 shares will vest in May, 2014 and 4,750 shares will vest in May, 2015; and 22,000 shares of the stock unit award granted in May, 2012, of which 5,500 shares will vest in May, 2013, 5,500 shares will vest in May, 2014, 5,500 shares will vest in May, 2015, and 5,500 shares will vest in May, 2016, in each case provided the executive is employed by the Company on each respective vesting date.
- (2) Consists of: 3,750 shares of the stock unit award granted in April, 2010, of which 1,875 shares will vest in April, 2013, and 1,875 shares will vest in April, 2014; 6,000 shares of the stock unit award granted in May, 2011, of which 2,000 shares will vest in May, 2013, 2,000 shares will vest in May, 2014, and 2,000 shares will vest in May, 2015; and 10,000 shares of the stock unit award granted in May, 2012, of which 2,500 shares will vest in May, 2013, 2,500 shares will vest in May, 2014, 2,500 shares will vest in May, 2015, and 2,500 shares will vest in May, 2016, in each case, provided the executive is employed by the Company on each respective vesting date.
- (3) Consists of: 6,000 shares of the stock unit award granted in April, 2010, of which 3,000 shares will vest in April, 2013 and 3,000 shares will vest in April, 2014; 5,625 shares of the stock unit award granted in May, 2011, of which 1,875 shares will vest in May, 2013, 1,875 shares will vest in May, 2014 and 1,875 shares will vest in May, 2015; and 8,500 shares of the stock unit award granted in May, 2012, of which 2,125 shares will vest in May, 2013, 2,125 shares will vest in May, 2014, 2,125 shares will vest in May, 2015, and 2,125 shares will vest in May, 2016, in each case, provided the executive is employed by the Company on each respective vesting date.
- (4)

## Potential Payments upon Termination and Change in Control

The Company has entered into change-in-control severance agreements with each of Messrs. Kubacki, Dyke and Schaffer providing for severance benefits for a period of up to 12 months in the event of termination within 12 months following a change in control (as defined in the agreements). The agreements provide for severance benefits only if (1) the Company undergoes a change in control (as defined in the agreement) and (2) within 12 months thereafter either (a) the Company (or its successor) terminates the employee (other than termination for cause), or (b) the employee terminates his employment for good reason (as defined in his agreement). The agreements do not provide for severance benefits in the event of an employee's death or disability, or in the event of his voluntary termination without good reason, or on account of termination for any reason if not preceded within 12 months by a change in control. The agreements provide that the employee shall not compete with the Company during the period in which he is entitled to receive severance payments. Except for such change-in-control severance agreements, none of the named executive officers has an employment agreement with the Company.

Each of the stock unit award agreements with Messrs. Kubacki, Dyke and Schaffer described in the Summary Compensation Table above provides that the vesting would accelerate upon a change in control. In

the event the Company had incurred a change in control on December 31, 2012 and terminated the employment of Messrs. Kubacki, Dyke and Schaffer on such date, the amounts paid out to such named executive officers would have been as follows:

## Payments and Benefits Upon Termination and Change in Control

(a) Name	(b) Salary and Bonus Continuation (\$) <sup>(1)</sup>	(c) Accrued Vacation (\$) <sup>(2)</sup>	(d) Health Benefits (\$) <sup>(3)</sup>	(e) Acceleration Of Equity Awards (\$) <sup>(4)</sup>	(f) Total (\$)
Raymond C. Kubacki 12 month Change in Control Termination Payments <sup>(5)</sup>	445,000	8,077	19,295	550,938	1,023,310
6 month Change in Control Termination Payments (change of location only) <sup>(5)</sup>	222,500	8,077	9,648	550,938	791,163
James V. Dyke 12 month Change in Control Termination Payments <sup>(6)</sup>	264,376	1,731	19,295	212,313	497,715
Michael I. Schaffer 12 month Change in Control Termination Payments <sup>(7)</sup>	260,000	6,425	19,295	216,344	502,064

The amounts in column (b) reflect the total amount of Base Salary, commission (if applicable) and Bonus compensation that would continue to be paid to the Executive during the indicated period following a termination (1) in connection with a change-in-control on December 31, 2012. Such amounts are calculated based on the actual base salary, commission and bonus compensation earned or accrued during the prior 12 month period preceding such termination.

(2) Accrued vacation is payable upon separation of service whether or not in connection with a change in control.

(3) The amounts in column (d) represent the amount payable by the Corporation during the applicable period for continuation of health benefits.

The amounts in column (e) reflect the acceleration of the vesting under stock unit awards granted under the Company's 2006 Incentive Plan triggered by a change in control, as provided in each executive officer's respective (4) stock unit award agreement with the Company. The valuation is determined by multiplying the number of stock unit awards that would have become vested on December 31, 2012 pursuant to such acceleration provision, times the closing price of the Company stock on such date (\$10.75 per share).

(5) Mr. Kubacki's arrangement provides for 12 months of salary and bonus continuation, in the event of a termination by the Company without cause (as defined in his agreement) or a termination by him for good reason (as defined in his agreement) in either case, within a 12 month period following a change in control of the Company (as such term is defined in the agreement), provided, however, that in the event of termination by Mr. Kubacki for good

reason solely on account of a change in his required place of employment, following a change in control, then in lieu of 12 months of salary and bonus compensation, his benefits would be limited to 6 months of salary and bonus compensation.

15

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(6) Mr. Dyke's arrangements provides for 12 months of salary, plus commission and bonus continuation (capped at 25% of base salary), in the event of a termination by the Company without cause (as defined in his agreement) or a termination by him for good reason (as defined in his agreement) in either case, within a 12 month period following a change in control of the Company (as such term is defined in the agreement).

(7) Dr. Schaffer's arrangements provides for 12 months of salary and bonus continuation, in the event of a termination by the Company without cause (as defined in his agreement) or a termination by him for good reason (as defined in his agreement) in either case, within a 12 month period following a change in control of the Company (as such term is defined in the agreement).

16

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## PRINCIPAL STOCKHOLDERS AND STOCKHOLDINGS OF MANAGEMENT

The following table shows, as of March 25, 2013, the number of shares beneficially owned (i) by those stockholders who are known to the Company to own beneficially more than five percent of the outstanding Common Stock of the Company, (including their addresses) (ii) by each director and nominee for director of the Company, (iii) by each named executive officer, and (iv) by all directors and executive officers as a group.

Name	Amount and Nature of Beneficial Ownership <sup>(1)</sup>	Percentage Owned <sup>(2)</sup>	
DePrince, Race & Zollo, Inc. 250 Park Avenue South, Suite 250 Winter Park, FL 32789	602,559 <sup>(3)</sup>	11.4	%
Renaissance Technologies LLC 800 Third Avenue New York, NY 10022	319,300 <sup>(4)</sup>	6.1	%
Raymond C. Kubacki	210,855 <sup>(5)(6)</sup>	3.9	%
Fred J. Weinert	145,332 <sup>(5)(6)(7)</sup>	2.7	%
Michael I. Schaffer	40,668 <sup>(5)(6)</sup>	*	
Harry Connick	35,164 <sup>(5)(6)</sup>	*	
Walter S. Tomenson, Jr.	28,307 <sup>(5)(6)</sup>	*	
James V. Dyke	9,125 <sup>(6)</sup>	*	
All Executive Officers and Directors as a group (7 persons)	482,796 <sup>(8)</sup>	8.8	%

\* denotes ownership of less than 1%

Shares are considered beneficially owned, for the purpose of this table only, if held by the person indicated as beneficial owner, or if such person, directly or indirectly, through any contract, arrangement, understanding, (1) relationship or otherwise has or shares the power to vote, to direct the voting of and/or to dispose of or to direct the disposition of such security, or if the person has the right to acquire beneficial ownership within sixty (60) days, unless otherwise indicated in these footnotes.

Pursuant to the rules of the Securities and Exchange Commission, shares of Common Stock which an individual or group has a right to acquire within 60 days pursuant to the exercise of options or pursuant to the vesting of stock (2) unit awards are deemed to be outstanding for the purpose of computing the percentage ownership of such individual or group, but with respect to options and stock unit awards, are not deemed outstanding for the purpose of computing the percentage ownership of any other person shown in this table.

Based on the statement on Schedule 13G/A dated February 12, 2013, DePrince, Race & Zollo, Inc., a registered (3) investment adviser, has sole voting power over 544,139 shares of common stock and sole dispositive power over 602,559 shares of Common Stock.

Based on the statement on Schedule 13G/A dated February 12, 2013, each of Renaissance Technologies, LLC, a (4) registered investment adviser, and Renaissance Technologies Holding Company has sole voting and dispositive power over 319,300 shares of Common Stock.

Includes the following number of shares of Common Stock which the individual had a right to acquire within 60 (5) days pursuant to the exercise of options: Mr. Kubacki 87,300; Mr. Weinert 18,650; Dr. Schaffer 19,600; Mr. Connick 16,738; and Mr. Tomenson 15,500.





- (6) Includes the following number of shares of Common Stock which the individual had the right to receive within 60 days pursuant to the vesting of stock unit awards: Mr. Kubacki 17,750; Mr. Weinert 3,850; Dr. Schaffer 7,000; Mr. Connick 3,850; Mr. Tomenson 3,850; and Mr. Dyke 6,375.
- (7) Includes 112,982 shares held by Mr. Weinert as trustee of a trust.

Includes 157,788 shares which the executive officers and directors had the right to acquire within 60 days pursuant (8) to the exercise of options, and 44,850 shares which were issuable to the executive officers and directors within 60 days pursuant to the vesting of stock unit awards.

## **Section 16(a) Beneficial Ownership Reporting Compliance**

Based solely on its review of copies of reports filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act ), or written representations from persons required to file such reports ( Reporting Persons ), the Company believes that all such filings required to be made by such Reporting Persons with respect to fiscal year 2012 were timely made in accordance with the requirements of the Exchange Act.

## PROPOSAL 2

# ADVISORY VOTE ON EXECUTIVE COMPENSATION

The Company is seeking the approval of its shareholders of an advisory resolution regarding the compensation of our named executive officers, as disclosed in this proxy statement under the section titled Executive Compensation. While this shareholder vote on executive compensation is only an advisory vote that is not binding on the Company or the Board of Directors, the Company values the opinions of its shareholders and will consider the outcome of the vote when making future compensation decisions.

As described more fully in the Executive Compensation section, the primary objective of our executive compensation program is to attract, retain and reward executive officers who contribute to our long-term success. We believe this requires a competitive compensation structure as compared to companies of a similar size in the same or similar industries in the region. Additionally, we seek to align a significant portion of executive officer compensation to the achievement of specified Company performance goals. Incentive cash bonuses are included to drive executive performance by having pay at risk so that a significant portion of potential annual cash compensation is tied to earnings targets. We also include restricted stock awards with time-based vesting provisions that are designed to align executive incentives with long-term shareholder interests.

We urge shareholders to read the Executive Compensation section above, which describes in more detail how our executive compensation policies and procedures operate and are designed to achieve our compensation objectives, as well as the Summary Compensation Table and the related compensation tables and narrative above which provide detailed information on the compensation of our named executive officers.

The 2012 fiscal year demonstrated our commitment to these principles and illustrated how our program responds to business challenges and the marketplace.

Performance-based compensation in the form of annual and long term incentives constituted, on average, over 40% of 2012 total compensation for our CEO and other named executive officers.

While non-financial targets were met, cash bonuses to named executive officers were paid out at only 26% of their total potential, due to the Company's lower net income in 2012.

Total compensation for each named executive officer was lower in 2012 than in 2011.

No increases in base salaries were authorized for named executive officers in 2013.

Psychemedics' leadership devoted a significant portion of 2012 on transition of its testing methodology to an enzymatic based technology. While this had a negative short-term impact on earnings, it is expected to reduce testing costs in future years with no compromise in testing quality and it is expected to expedite bringing new testing products to market.

Equity compensation awards, which comprised 100% of NEO long term compensation, continued to play an important role in rewarding NEOs for the achievement of long-term business objectives and providing incentives for the creation of stockholder value.

Our shareholders received a total return of 25% in 2012, exceeding comparable indices used to measure the Company's relative performance.

The Company's commitment to these principles has long preceded the 2012 fiscal year.

Average annual increases in base salaries for the named executive officers over the past five years averaged less than 2% per year.

In 2009, the peak of the recession, the Company opted not to award any stock unit awards to any officer or director. In addition, the officers took a 10% pay cut for six months of 2010.

In September, 2010, for the fourth year in a row, DeMarche Associates, Inc., a leading investment research and financial consulting firm, recognized Mr. Kubacki as one of top 100 chief executive officers in the nation, based on the amount of shareholder value generated over the prior 3-year period per unit of compensation paid to him during such period.

19

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The Company has been profitable every year since 1993, including the recession year of 2009, and has paid a dividend every quarter over the last 16 years.

In keeping with current best practices, none of our named executive officers is subject to an employment agreement other than a change-in-control severance agreement, each of which is triggered only in the event of a double trigger a change of control combined with involuntary termination of employment. The Company offers minimal perquisites benefits, no guaranteed bonuses, no tax gross ups, four-year vesting for all executive equity awards and an independent compensation committee.

In light of the above, the Compensation Committee and the Board of Directors believe that the policies and procedures articulated in the Executive Compensation section above are effective in achieving our goals and that the compensation of our named executive officers reported in this proxy statement has supported and contributed to the Company's success.

For the reasons discussed above, we are asking our stockholders to indicate their support for our NEO compensation as described in this proxy statement by voting FOR the following resolution. This vote is not intended to address any specific item of compensation, but rather the overall compensation of our NEOs and the philosophy, policies and practices described in this proxy statement.

RESOLVED, that the stockholders approve, on an advisory basis, the compensation of the named executive officers, as disclosed in Psychemedics Corporation's Proxy Statement for the 2013 Annual Meeting of Stockholders pursuant to the compensation disclosure rules of the Securities and Exchange Commission.

**Psychemedics Board of Directors recommends a vote  
FOR the non-binding,  
advisory proposal to approve the executive  
compensation of our named  
executive officers, as disclosed in this proxy  
statement.**

# **PROPOSAL 3**

## **ADVISORY VOTE ON THE FREQUENCY OF FUTURE ADVISORY VOTES ON EXECUTIVE COMPENSATION**

Pursuant to Section 14A of the Exchange Act, we are asking our shareholders to cast a non-binding advisory vote regarding how frequently the Company should seek from its shareholders a non-binding advisory vote (similar to Proposal 2 above) on executive compensation. By voting on this frequency proposal, shareholders may indicate whether they would prefer that the advisory vote on the compensation of our named executive officers occur every three years, two years, or one year. The Board recommends that such a vote occur every three years, but shareholders are not voting to approve or disapprove the Board's recommendation. Shareholders may also abstain from voting on the proposal.

After consideration of this proposal, the Compensation Committee has recommended to the Board of Directors that future advisory votes on executive compensation that occur every three years would be the most appropriate policy for Psychemedics Corporation at this time. Therefore, the Board recommends that you vote for future advisory votes on executive compensation to occur triennially. In coming to this decision, the Board recognized that our executive compensation programs are designed to promote a long-term alignment of pay and performance over multi-year periods. The Board believes that an advisory vote on a three-year cycle will provide shareholders and advisory firms sufficient time to evaluate the effectiveness of our executive compensation philosophy, policies and practices in the context of our long-term business results.

In addition, the Board believes that an annual vote on executive compensation will not allow sufficient time for shareholders to meaningfully evaluate any changes to our executive compensation policies and practices, including changes made in response to the outcome of a prior advisory vote on executive compensation. For example, if our evaluation of the executive compensation vote in May, 2013 causes us to make changes to our executive compensation program in January, 2014 (around the beginning of our fiscal year, when executive compensation decisions are customarily made by our Compensation Committee based on Company and individual performance during the previous fiscal year), those changes may only be in place for a few months before the next vote would take place in May, 2014. A triennial vote also provides the Company with additional time to engage with shareholders and meaningfully and thoughtfully respond to shareholders' views.

The option of three years, two years, or one year, that receives the highest number of votes cast by shareholders will be considered the frequency for the advisory vote on executive compensation that has been selected by shareholders. However, this advisory vote is not binding on the Company or our Board of Directors. Our Board of Directors will take into account the result of the vote when determining the frequency of future advisory votes on executive compensation. Because this vote is advisory and not binding on the Company or our Board of Directors, the Board of Directors may decide that it is in the best interests of the Company and our shareholders to hold an advisory vote on executive compensation more or less frequently than the option considered approved by our shareholders.

Stockholders may cast their votes their preferred voting frequency by choosing the option of three years, two years, one year, or abstain from voting in response to the resolution set forth below.

RESOLVED, that the option of once every three years, two years, or one year that receives a

plurality of votes cast for this resolution will be determined to be the preferred frequency with which Psychemedics Corporation is to hold an advisory stockholder vote to approve the compensation of the named executive officers, as disclosed pursuant to the Securities and Exchange Commission's compensation disclosure rules.

**Psychemedics Board of Directors recommends a vote  
for conducting  
future advisory votes on executive compensation  
every THREE years.**

Proxies received in response to this solicitation will be voted for the THREE YEARS option of this proposal unless otherwise specified in the proxy.

## **PROPOSAL 4**

# **RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Company's Audit Committee has appointed BDO USA, LLP as the Company's independent registered public accounting firm for fiscal year 2013 and recommends ratification of such appointment by the stockholders. During the 2012 fiscal year, BDO USA, LLP served as Psychemedics' independent registered public accounting firm and also provided certain tax and non-audit services as described above. Although the Company is not required to seek stockholder approval of this appointment, the board believes it to be sound corporate governance to do so. If the appointment is not ratified, the Audit Committee will investigate the reasons for stockholder rejection and will reconsider the appointment.

Representatives of BDO USA, LLP will be available at the Annual Meeting to respond to questions.

**Psychemedics Board of Directors recommends a vote FOR the ratification of the Audit Committee's appointment of BDO USA, LLP as the Company's Independent Registered Public Accounting Firm.**

## **STOCKHOLDER PROPOSALS**

Proposals of stockholders intended to be presented at the 2014 Annual Meeting of Stockholders must comply with Rule 14a-8 of the Securities and Exchange Commission issued under the Securities Exchange Act of 1934, and must be received at the principal executive offices of the Company not later than December 7, 2013.

## **OTHER MATTERS**

The Board of Directors knows of no other matters which may come before the Annual Meeting. However, if any matter not now known is presented at the Annual Meeting, it is the intention of the persons named in the accompanying form of proxy to vote said proxy, or any proxy that you may download from [www.psychemedics.com/proxy](http://www.psychemedics.com/proxy), in accordance with their judgment on such matter.

The Company will bear the cost of solicitation of proxies. Solicitations of proxies by mail may be followed by telephone or other personal solicitation of certain stockholders by officers or other employees of the Company.



## GENERAL INFORMATION

The Company's 2012 Annual Report is being mailed to shareholders with this Proxy Statement.

A copy of the Company's Annual Report on Form 10-K for the year ended December 31, 2012 may be obtained without charge by writing to the Company at Investor Relations, Psychemedics Corporation, 125 Nagog Park, Acton, Massachusetts 01720, or by viewing the Investor Information section of the Company's website at [www.psychemedics.com](http://www.psychemedics.com).

By order of the Board of Directors,  
EDWARD S. BREWER, JR.,  
*Secretary*

April 5, 2013

# PSYCHEMEDICS CORPORATION

Using a black ink pen, mark your votes with an X as shown in this example. Please do not write outside the designated areas. x

## Annual Meeting Proxy Card

PLEASE FOLD ALONG PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE.

(A)

### Voting Items

The Board of Directors recommends a vote **FOR** all of the following nominees:

1. Election of Directors.

- Nominees:
- (01) Raymond C. Kubacki
  - (02) Harry F. Connick
  - (03) Walter S. Tomenson, Jr.
  - (04) Fred J. Weinert

Mark here to vote **FOR** all nominees.  Mark here to **WITHHOLD** vote from all nominees

For All **EXCEPT** To withhold a vote for one or more nominees, mark the box to the left and the corresponding numbered box(es) to the right.  01  02  03  04

The Board of Directors recommends a vote **FOR** the following Item  
(see page 19 of Proxy Statement):

- |                                            |                       |                       |                       |
|--------------------------------------------|-----------------------|-----------------------|-----------------------|
|                                            | <b>For</b>            | <b>Against</b>        | <b>Abstain</b>        |
| 2. Advisory vote on executive compensation | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |

The Board of Directors recommends you vote **3 YEARS** on the following Item  
(see page 21 of Proxy Statement):

- |                                                                                         |                       |                       |                       |                       |
|-----------------------------------------------------------------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                                                                                         | <b>3 Years</b>        | <b>2 Years</b>        | <b>1 Year</b>         | <b>Abstain</b>        |
| 3. Advisory vote on the frequency of holding an advisory vote on executive compensation | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |

The Board of Directors recommends a vote **FOR** the following Item:

- |                                               |                       |                       |                       |
|-----------------------------------------------|-----------------------|-----------------------|-----------------------|
|                                               | <b>For</b>            | <b>Against</b>        | <b>Abstain</b>        |
| 4. Ratification of Appointment of BDO USA LLP | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |

(B)

### Non-Voting Items

Change of Address Please print your new address below. Comments Please print your comments below

**(C) Authorized Signatures** This section must be completed for your vote to be counted. Date and Sign Below.

Please sign exactly as name(s) appears hereon. Joint owners should each sign. When signing as attorney, executor, administrator, corporate officer, trustee, guardian, or custodian, please give full title.

Date: \_\_\_\_\_ Signature 1: \_\_\_\_\_ Signature 2: \_\_\_\_\_

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Dear Stockholder:

Please take note of the important information enclosed with this Proxy Ballot. Your vote counts, and you are strongly encouraged to exercise your right to vote your shares. Please mark the boxes on the proxy card to indicate how your shares will be voted. Then sign the card and return your proxy in the enclosed postage paid envelope. Your vote must be received prior to the Annual Meeting of Stockholders, May 23, 2013. Thank you in advance for your prompt consideration of these matters.

Sincerely,  
Psychemedics Corporation

IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE STOCKHOLDERS MEETING TO BE HELD ON MAY 23, 2013 FOR PSYCHEMEDICS CORPORATION. THE FOLLOWING MATERIAL IS AVAILABLE AT [www.psychemedics.com/proxy](http://www.psychemedics.com/proxy)

PROXY STATEMENT  
ANNUAL REPORT

PLEASE FOLD ALONG PERFORATION, DETACH AND  
RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE.

## **Proxy Psychemedics Corporation**

PROXY FOR 2013 ANNUAL MEETING OF STOCKHOLDERS  
TO BE HELD ON MAY 23, 2013

THIS PROXY IS SOLICITED BY THE BOARD OF DIRECTORS

The undersigned hereby appoints Raymond C. Kubacki, attorney of the undersigned (with full power of substitution), to vote for and in the name of the undersigned, at the 2013 Annual Meeting of Stockholders of Psychemedics Corporation (the Company) to be held on Thursday, May 23, 2013 at 2:00 p.m. at the Liberty Hotel, 215 Charles Street, Boston, MA 02114 and any adjournments thereof, according to the number of shares and as fully as the undersigned would be entitled to vote if personally present.

Without limiting the general authorization hereby given, said proxy is instructed to vote or act as follows on the proposals set forth in the Company's Proxy Statement dated April 5, 2013 and on such other matters as may properly come before the meeting. If no such instruction is given, this proxy will be voted in accordance with the Board of Directors' recommendations.

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PLEASE VOTE, DATE, AND SIGN ON REVERSE SIDE AND  
RETURN PROMPTLY IN THE ENCLOSED ENVELOPE.

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