Financial and Economic Crisis — Law Firms

Cozen O'Connor: On Top Of The Hot Issues In Executive Compensation

*The Editor interviews **Jay A. Dorsch,** Chair of Cozen O'Connor's employee benefits and executive compensation practice, and **L. Stephen Bowers,** Member, Cozen O'Connor.*

Jay A. Dorsch

L. Stephen Bowers

Editor: Describe your firm's employee benefits, and executive compensation practice and your roles.

Dorsch: Our practice includes all facets of qualified retirement and executive compensation plans, nonqualified deferred compensation (including the application of IRC Section 409A), equity-based compensation and multi-employer plans. We counsel clients on the implications of the fiduciary responsibility rules under ERISA, as well as the employee benefit aspects of mergers and acquisitions. The firm also advises employers and third party administrators in the health and welfare area, including flex plans, HIPAA and COBRA. In addition, we have a substantial ERISA litigation practice.

Bowers: While I work in all aspects of our practice, my focus is on health and welfare benefits. In recent years, our executive compensation area has grown as the heightened level of regulation has significantly increased both the complexity of the area and the penalties for failing to comply with the new regulatory requirements.

Editor: How has the economic crisis affected your practice area?

Dorsch: There has been an upswing in work related to reductions in force and the restructuring of compensation arrangements. We have also been more heavily involved in counseling clients on reducing benefits as cost savings measures.

Editor: Tim Geithner has called for board compensation committees to be made up entirely of independent directors. How great a change is this from current practice?

Dorsch: Many exchanges already require compensation committees to include independent directors, so the real impact of Geithner's proposal would be on private companies and smaller public companies. Moreover, there could be significant impact if the regulations redefine who is considered "independent" in a way that would disqualify certain existing committee members.

Editor: Are you seeing a trend toward compensating executives based on long-term performance?

Dorsch: In most companies, both long-term and short-term incentives are typically part of the compensation package. The goal, of course, is to create a package that provides the right balance of risk and, at the same time, is attractive enough to retain the company's key employees. The more senior the position, the greater the risk portion of compensation. A major concern is ensuring that long-term incentives provide just that – a long-term incentive, not just another part of annual compensation.

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Editor: You advise board compensation committees. What are their principal concerns today?

Dorsch: Compensation committees need to review their philosophy and determine whether it is still appropriate in light of the impact the economic crisis has had on their company's business. Similarly, a company's compensation programs should be evaluated to determine if they still support the compensation strategy, after taking into account how the business is performing in this tough economy, and whether the programs are sufficient to retain the most important and productive employees and recruit the best talent.

While it is always a challenge for compensation committees to determine the right benchmarks, and metrics for measuring and compensating management performance, the current economic crisis has made setting performance criteria particularly difficult this year. The decisions being made today will be judged in hindsight at a time when there have already been more than a dozen bills and resolutions on executive compensation from Congress and the administration in the past several months. This makes it challenging to judge the appropriateness of the decision making. Compensation committees are also working on getting a better understanding of the value of the total compensation package, including severance and SERP benefits, to be able to make more informed decisions on types and amounts of compensation.

Compensation committees need to be aware of the recent pronouncements from the Obama administration on executive compensation, and consider their implications for the company's programs. For companies subject to TARP, the committee will have additional requirements, such as an obligation that all directors be independent and perform a semiannual review to evaluate the risk posed by compensation plans to the company. Finally, the compensation committee should consider how the company's programs will be viewed by proxy consultants.

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Editor: Are you seeing any clawback provisions?

Dorsch: Clawbacks have become more prevalent in larger companies. TARP has a clawback requirement, which has increased both the focus on clawbacks as well as related shareholder proposals. Among the more difficult issues concerning clawbacks are determining the right triggers for repayment and structuring the provisions, so that there is a realistic chance of being able to recoup funds.

Editor: How do you interface with the compensation consultants?

Dorsch: Typically, consultants provide guidance for structuring compensation arrangements and, ideally, keep us in the loop. As counsel, we are asked to implement the proposed plans and address legal compliance. We can be more effective when we have been part of the process of crafting the programs, rather than being brought in at the last minute to "bless" them.

Bowers: Consultants are working on developing options to respond to the new limitations. However, this is such a dynamic area right now that solutions developed today may not work tomorrow. Everyone is sort of treading water, because they are not sure what the actual rules are going to be.

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Editor: Tim Geithner also called for shareholder "say on pay." Do you see "say on pay" as having a significant impact on the way executive compensation plans are structured?

Dorsch: It's unclear what impact "say on pay" votes will have. A shareholder vote that "yes this is a good program" or "no this is not a good program" doesn't provide any guidance on why the shareholders have concluded a program is or is not appropriate. And, under the current approach, the vote is not binding. While many companies have incorporated some type of "say on pay," primarily because it is required by TARP, the evidence to date in the U.S. does not indicate it is having much of an impact on votes. Favorable "say on pay" votes may provide companies support if the reasonableness of a compensation program is challenged in the future.

Editor: Do you have concerns about pay caps?

Dorsch: If certain industries are going to be subject to caps, while others are not, the best talent may look to work in those industries that do not have these caps. Caps on compensation will also force attention to those types of compensation areas that are not subject to the cap. That was certainly the case when the million-dollar cap on deductible compensation was enacted.

The compensation landscape will continue to be uncertain for some time. Companies' in-house counsel and their other advisors should carefully monitor ongoing developments to determine the best course of action.

Please email the interviewees at jdorsch@cozen.com and sbowers@cozen.com with questions about this interview.