

EXECUTIVE COMPENSATION: LOOKING AT THE WHOLE PACKAGE



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You might not think of yourself as an “executive,” but if you run your own business, you’re probably the President and CEO. And if you are helping build a business of any kind – whether a start-up or an established organization – you are familiar with the task of attracting and retaining leadership talent.

The topic of executive compensation has garnered a lot of press in the past few years, as the salaries of bank and auto executives were scrutinized in the wake of government bailouts. Among Canada’s biggest companies, the median pay for top executives dropped to \$3.99 million in 2009 from \$4.39 million in 2008. With the economy showing signs of tentative recovery, executive salaries are likely to rise again in 2011. Sounds good for executives. However, salary is not the sole component in a “package” designed to attract exceptional leaders.

What else goes into that “package”? The following are some considerations when developing a “package” that will attract and retain corporate leaders— both for executives and the companies they lead:

- **Base Salary & Benefits:** An executive’s compensation package is usually built around a “base salary,” the amount of which will depend on the company, the industry and the economy. A well-drafted executive agreement spells out the details of salary and medical benefits, along with corporate expense and travel policies.
- **Bonuses:** A “pay for performance” approach can motivate leaders of operating groups or divisions within the company. However, any bonus policy should be clearly communicated and reflect the actual method of bonus determination: for example, if bonuses are reserved for senior management only and awarded at the sole discretion or whim of the CEO,

then implying that all employees will be bonused on quarterly sales targets will lead to confusion and resentment. Well-articulated policies can help avoid any misunderstandings.

- **Equity & Stock-Options:** Equity refers to an ownership stake in the company, whereas a stock-option is an opportunity to buy shares in the company at some later date at a pre-determined price. Compensation based on equity or stock-options encourages executives to take a personal financial interest in the long-term growth of the company. Executives will be motivated to build the company to the extent they are personally invested as part owners. While this form of compensation is not for every company, it can be a useful tool to attract and retain talent. Companies should make a distinction between equity ownership and stock-options, and should be mindful of securities regulations and tax issues. Consider a plan that addresses both short and long-term incentives, and, if stock-options are appropriate, addresses vesting periods, exercise periods and option pricing. One more important point: once someone is a shareholder in your company, it can be difficult to remove them as a shareholder, so make sure the decision to offer equity or stock-options is carefully considered and discussed with your advisors.
- **Employment Issues:** Independent directors may sit on the board without being employees, but executives at the operating level are typically full-time employees of the company. A carefully-drafted executive employment agreement often addresses salary and bonus compensation, employment policies, termination provisions, confidentiality, non-competition, and non-solicitation.

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- **Duties of Directors and Officers:** Sitting on a board of directors is not about cigars and wood-paneled rooms anymore. The task has become increasingly complicated and involved. Directors tend to committees, read reports, and become active advisors. With this authority comes a number of important duties: the duty to act honestly, in good faith, and in the organization's best interest. The corporation's failure to abide by certain legal obligations – including deducting and remitting employee source deductions, environmental damages, securities infractions, and in some cases intellectual property infringement – can lead to personal liability for directors. Ignorance is not a defense - so directors and officers need to be actively informed. Directors and officers also owe special “fiduciary” duties to the company, including the duty to avoid being in conflict of interest with the company. A director's indemnity and D&O insurance can help mitigate some of these risks.
- **Intellectual Property Issues:** What would you do if the VP of Sales walked out the door with trade secrets such as customer lists, access to business plans, and pricing margins: all of which would be valuable to competitors? The ownership of inventions and trade-secrets is an important consideration for all businesses, not just technology companies. Both executives and their companies need to turn their minds to IP issues such as confidentiality, invention assignment and trade-secret protection protocols. Intellectual property infringement by the company can also tag directors with personal liability.
- **Corporate Ethics:** Consider the case of an executive who accepts a free five-star vacation from a vendor, and then concludes a major purchase from that vendor. Even if there was no conflict, the perceived conflict itself can be detrimental to both the organization and the executive, as well as the relationship with the vendor. Carefully-drafted conflict of interest and corporate ethics policies address issues of “hospitality” and corporate gifts, and provide protocols for directors in disclosing and managing conflicts.
- **Say on Pay:** “Say on Pay” refers to shareholder approval of executive compensation. The Canadian Coalition for Good Governance published an updated “Say on Pay” policy for public companies and in 2010 a number of Canadian public companies began conducting such votes. The current trend is to permit shareholders to play an oversight role on the company's general approach to executive compensation; however, the specific details of compensation packages are left

to the board's determination.

Get advice before finalizing your compensation packages for hiring and retaining executives. Our experienced business law group has the expertise to advise both executives and corporations on the process from hiring to firing, including corporate matters, board advice, employee stock-option plans, securities laws, and intellectual property issues. ▲

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