



The Evolution and Revolution in Executive Compensation

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A wider lens on workplace law

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Reminder, for CLE credit, there will be two codes during the session. You need to record them to prove participation.



A wider lens on workplace law



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Evolution “Triggers” for Change

- Payments to executives despite corporate financial difficulties (e.g., Enron Corporation executives received large payouts shortly before the company failed)
- Large payments to executives with short service (e.g., Disney litigation regarding executive compensation)
- Shareholders vote “no” to compensation proposals involving significant executive compensation



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Laws Enacted

- Sarbanes-Oxley Act - increased accountability of public company executives for their acts;
- Internal Revenue Code Section 409A - designed to prevent executives from manipulating deferred compensation payment dates;
- Dodd Frank Act - assures greater disclosures to shareholders concerning executive pay; and
- The Tax Cuts and Jobs Act - addresses loopholes that permitted companies to avoid the \$1 million cap on compensation deductible as a business expense under Code §162(m).



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Does Money Buy Results?

- What is the correlation between the amount of an executive's compensation and company performance?
- Are base wages -- even high wages -- a good motivator of workplace performance?
- Are special executive compensation arrangements a "motivating force" for the executives?



Code One: 225



Major Consideration: Executive Compensation That Causes Negative Publicity or Scandal

- Justifying executive compensation despite company's performance
- Defending pay ratio of company executives to median employee pay
- Argument - recruiting/retention to get top talent
- Strategy - tying corporate performance to executive pay
- Minefield - managing expectations

PUBLICITY



SCANDAL!

PwC, a member of the PricewaterhouseCoopers International Ltd., Network, and the London School of Economics and Political Science, published a research study on the psychology of incentives in 2012 ...

What is important to Executives?

- The work and the work environment;
- Compensation paid in a short time-period from work performed;
- Amount of risk;
- Incentives based upon performance goals the executive can control;
- Fairness;
- Recognition; and
- Simplicity and clarity in plan design

Common Executive Compensation Types:

- Stock Options---incentive and non-qualified;
- SARs and Phantom Stock;
- Bonus based upon Executive's area of supervision;
- Long-term incentives based upon Company EBITDA or stock price; and
- Common deferred compensation plans



Tax Considerations

- Code section 162(m)--\$1 million compensation limit on deduction for compensation for employing company; and
- Code section 280G, golden parachute:
 - No deduction on excess parachute payments for employer; and
 - Excise tax equal to 20% of excess parachute payment levied on executive under Code section 4999.



The Revolution

- Understand how various forms of executive compensation are actually perceived – by the executive, shareholders and others
- Factor in the tax consequences to both the company and executive, and
- Consider the potential risk/reward (including defending the structure) ...



Code Two: 750

The Revolution

- Know what your executive values (job, recognition, money, equity, prestige);
- Keep compensation plans simple and clear;
- Award performance in short bursts;
- Establish performance goals for elements the executive can control;
- Recognize discount amounts attributable to executive perception and tax realities;



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Continued....

- Recognize the distinction of an "award" vs. retirement planning;
- Remember that executives can buy stock with after-tax money;
- Analyze actual costs/benefits to proposed plan designs to achieve economic efficiency; and
- Consider claw backs to protect the company (and provide additional "motivation").



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Questions?



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