Project: *Corporate Counsel Part I (Unintended Consequences) – Law Firms*

Executive Compensation: A Practice Area In Transition Since The Corporate Scandals

The Editor interviews ***Michael S. Sirkin****, Senior Partner in the Executive Compensation and Employee Benefits Group at Proskauer Rose LLP.*

Editor: Mr. Sirkin, would you tell our readers something about your professional background?

Sirkin: I graduated from Columbia Law School in 1972, and after a brief time with a small firm involved in securities work I joined Gilbert, Segall & Young, where I spent the next 15 years. ERISA was enacted at the start of my career, and I was invited to become the firm expert on it, in addition to my corporate practice. From that combination, my practice evolved into executive compensation, which is a combination of the two areas. I came to Proskauer in 1989, and I've been here ever since.

Editor: What attracted you to Proskauer?

Sirkin: I was particularly attracted to breadth of the practice and the firm's commitment to clients in the compensation and benefits area. This area was becoming increasingly complicated, and it was a matter of some importance that I have the strong support of a labor practice and a securities practice as backup for my own.

Editor: Please describe your practice. How has it evolved over the course of your career?

Sirkin: My practice today is a combination of employee benefits and executive compensation. On the executive compensation side, I do a lot of work for companies setting up a variety of non-qualified and equity plans for their executives. I am also engaged in advising compensation committees, and, on the other side of the fence, I represent a large number of senior executives in negotiating employment and severance agreements. On the employee benefits side, I handle all aspects of traditional employee benefits work, and, in addition, I have developed a special expertise in benefits and compensation for tax-exempt organizations.

Editor: Would you share with us the ways in which your practice in general, and the executive compensation area in particular, has changed since the recent corporate scandals.

Sirkin: The practice has become broader in scope and more complicated. With Sarbanes-Oxley, new SEC and other federal regulations, new rules from the securities exchanges, new accounting rules, new tax rules on deferred compensation, and emerging case law, we have to consider a variety of new factors in everything from developing equity plans to negotiating employment arrangements. In advising our clients, we must also pay attention to what the investment community is saying, to say nothing of the pronouncements of governmental agencies. Above all, lawyers who negotiate employment contracts from any side must be much more conscious of what is reasonable and doable in today's environment. The practice has become much more complicated.

Editor: What about the responsibilities of members of the governing board's compensation committee in a public company? What are the challenges here?

Michael S. Sirkin

Sirkin: I think that the compensation committee has the most difficult job of any committee of the board. Many disagree and say that it is the audit committee that has the toughest job. Certainly the audit committee has considerable responsibility and exposure to liability, *but* there is general agreement on the intended results for the audit committee. That is *not* the case with the compensation committee. The compensation committee members must walk a very fine line between incentivizing the executives and giving them security and not overly rewarding them if they are unsuccessful. The challenge is to come up with solutions everyone can live with.

Editor: What outside expertise – consultants, lawyers etc. – should the committee utilize in its deliberations?

Sirkin: The compensation committee members do not have to be experts themselves, although they should be reasonably knowledgeable about the area and understand the concepts. Every compensation committee needs to retain a compensation consultant, and in many cases they should have their own compensation lawyer. The added expense this entails is modest compared to the sums under discussion, and access to industry data and information on the market injects an element of fairness and objectivity into the process that is extremely important. Doing without means running a significant risk and, more importantly, not achieving the desired goal.

Editor: And the use of benchmarks and comparative data? How does this square with the reality of corporate America – where each company prides itself on having a "unique" culture?

Sirkin: This is one of the most difficult issues that the compensation committee faces. Peer data can be misleading. And it can also be tweaked to say a lot of different things. The challenge is to come up with a standard that is both fair and reflects the marketplace. It is important to inject comparative information into the discussion, but no one has managed to come up with a good answer as to how to determine the *right* comparisons. There is a range, and almost everyone knows at what point that range begins to become out of line, whether too high or too low. It is determining what is fair and market-based in the middle of the range that is the challenge. If the committee gets it wrong, and the compensation is too generous, it is rightfully the recipient of criticism. If the committee fails to be generous enough, the company runs the risk of losing key executives, and it, the committee, is equally subject to criticism.

Editor: What about disclosure responsibilities? Is more better than less these days?

Sirkin: A corporate board or board committee, to say nothing of the senior management team, should engage in no conduct that they fear seeing on the front page of the newspaper. As much as possible should be disclosed to the shareholders and to the general public. That said, it is an open question whether simply more disclosure helps or adds to the confusion. Much of what is disclosed in the present climate is highly technical in nature, and it is unclear how much this type of disclosure adds to the discussion. The key should be to make the disclosure understandable and focus on the material items.

Editor: In the end, the committee must make decisions which have a strong subjective element – what is a particular executive worth? Many factors must be weighed. Please tell our readers which ones ought to be emphasized and which ones avoided.

Sirkin: There is a strong subjective element here, and each situation is different. For example, if the committee is dealing with an employee who has come up through the ranks of the company it is important to assess the culture of the company and the precedents that have been established in connection with rewarding high performance and fair arrangements for retirement after long service. It is also necessary to review precedents where things don't work out, and the executive must be eased out. Where the committee is trying to bring in a new senior executive from the outside, an added complication concerns what that person is giving up. Good compensation committees work hard to find the middle ground, and giving the committee some latitude, some freedom to compromise – without, of course, giving away the company – is always a good idea.

Editor: **Would you share with us the particular challenges that the compensation committee faces in fixing a severance package for a CEO departing involuntarily.**

Sirkin: I think there are two sides to this. The ideal situation is to have severance prescribed in the contract going in. A contract of employment is like a pre-nuptial agreement: they both should be written when everyone is in love, not when things are falling apart. Again, it is important to try to establish a fair and objective middle ground that provides the executive sufficient protection against, say, a termination based on personalities, style or impatience, such that he does not feel he must jump ship at the first sign of trouble, but not so much protection that he cannot be fired without paying him an amount out of all proportion to his position and responsibilities. The life expectancy of a CEO these days is somewhere between three and a half and five years, on the average, and it takes time to land a new job. Accordingly, some security is in order but not a severance package that essentially permits him to retire a rich man.

Editor: Equity compensation has received considerable attention since the scandals. If the committee gets it wrong in the sense of overcompensating, it can be accused of dereliction of its primary responsibility to the shareholders. If the committee gets it wrong by not compensating enough, it may fail to incentivize the executive – the whole purpose of the exercise – and that, too, can be a dereliction of duty. How do you walk this tightrope?

Sirkin: The first step in this particular exercise is to determine what the executive should be awarded if the company *is* successful. Success may be the result of an executive having done a good job, but even if it means nothing more than that he did not get in the way of the marketplace, it is to a degree welcome. It is also necessary to determine what he receives if the company is *not* successful. Both positions must be worked out in advance. It is important to avoid the situation where the executive receives a substantial award notwithstanding the fact that the company is *not* successful, but at the same time to provide him with reasonable security.

Editor: **How do you deal with the vesting of equity rights on termination? Are there any "best practices" here?**

Sirkin: Generally there should be no or limited additional vesting on the termination after a relatively short period of employment because the executive has not earned it. There are situations, however, where the executive is terminated because of a personality clash or a difference with the governing board concerning corporate goals. The executive should be rewarded for the work he has done in such a circumstance, provided, of course, the work merits reward. There is an additional problem where the executive has been brought in laterally. Very often the equity segment of his compensation is makeup equity. On termination – where he is leaving involuntarily – the vesting of additional equity is often justified. This may also be the case where the executive receives reduced base salary or cash bonuses and his compensation is intentionally heavily oriented towards equity.

Editor: In light of what appears to be an enhanced exposure to liability on the part of corporate directors of public companies, have you encountered evidence of a reluctance to serve on corporate boards?

Sirkin: The most important issue for persons looking at whether to accept an invitation to join the board of directors of a public company concerns satisfying themselves as to the quality of the CEO, CFO and the rest of the senior management team. Right up there with that issue is an understanding of the time commitment and responsibility that board membership entails and the adequacy and extent of directors and officers liability insurance. Today people are much more conscious of the risks involved in taking on these positions than they were in the past. As a result, I think smaller companies are finding it more difficult to recruit the people they want for their governing boards.

Please email the interviewee at msirkin@proskauer.com with questions about this interview.