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5 Tips For Crafting The Perfect Exec Compensation Package

By **Emma Cueto**

Law360 (April 12, 2018, 2:36 PM EDT) -- An executive compensation package can look wildly different from industry to industry and company to company, but when putting one together, there are some key considerations that plan writers should always keep in mind.

From the basics of a salary to the many implications of the tax code, there are numerous components to work out. Making sure that a deal is structured well and is comparable to others within a company and industry can save a company major headaches down the road.

Here, experts share five tips to help companies put together the best deal possible and prevent unnecessary trouble — and potential legal battles.

Consider the Company Culture

It's important that an executive benefits package fits within the larger culture of the company, experts say. For some companies, this means simply sticking to the compensation standards that the company has already laid out.

"A lot of companies will try to avoid having to individually negotiate complex arrangements with people," said Seth Safra, an employee benefits and executive compensation attorney at Proskauer Rose LLP. "So they'll try to set up a basic structure for a bonus or incentive plan, a severance plan, a retirement plan."

But whether a company already has a basic package or not, it's important to pay attention to how a new executive's package will compare to the ones existing employees already have.

Giving a newcomer too much is a quick way to sow resentment, said Mims Maynard Zabriskie, who is part of the executive compensation group at Morgan Lewis & Bockius LLP.

"You can have people be disgruntled if they feel like all the new people get a better deal than the people who've been there all along," she said.

Beyond compensation, different companies come with different considerations based on size, whether it's publicly traded or even the organization's mission.

Organizations that work with vulnerable populations can be particularly proactive about including in their contracts just cause provisions for firing an executive, said Susan Foreman Jordan, the co-chair of Fox Rothschild LLP's employee benefits and compensation department.

“Publicly taking a position ... or being accused of something that is contradictory to the policies and philosophies of that company could be an issue,” she said.

For instance, a company that works with children would be particularly sensitive if an executive is accused of child neglect, she noted.

Some companies' executive compensation agreements also try to respond to particular internal problems, according to Andrea S. Rattner, another attorney with Proskauer's employee benefits and executive compensation working group.

If a company has recently seen former executives poach employees, the organization might want particularly strong noncompete terms in any new contracts, she said.

“I find the companies focus on different events that are occurring outside in the business world, and also what's going on internally,” she said.

Know the Marketplace

Just as different companies have different needs, different industries have different notions of what is standard. Even basic ideas about compensation can vary.

“There are certain industries where a salary is the main part of compensation and a bonus is just an additional piece based on performance, whereas there are others where a bonus really makes up a very large percentage of the compensation,” Safra said.

Understanding an industry's particular nuances is key.

For publicly traded companies, getting a sense of standard compensation and benefits can be easy, since much of the information is publicly available. But even private companies should care about market standards, experts say.

“For private companies, it's a little harder because there's not the same publicly available private company data. [But] there are surveys available on a more limited basis, so you can get some benchmarking data,” Zabriskie said.

Knowing whether what a company offers, both as pay and in benefits, is in line with others in the industry is an important part of structuring a deal.

It's All in the Details — and the Details Need to Be Clear

While there are big-picture considerations to keep in mind, executive compensation and benefits agreements really come down to the minute details, from making sure to account for every consideration of tax law, to determining whether and how a bonus might be paid out if and when an executive is fired, to debating the finer points of what constitutes “good reason” for an executive to walk away.

Trying to set terms around a change of control in the company can spawn a whole series of considerations that might not seem apparent, said Rattner.

“A nonlawyer or a nonspecialist might think, ‘Oh, you just make additional payments in that case to give the executive extra protections.’ But there are added tax, governance, definitional and other considerations that apply when dealing with a change of control,” she said.

And while many things might seem standard, variation in state law can cause trouble as well.

“There are a lot of nuances in state law, especially with noncompete covenants,” Zabriskie said. “So you want to make sure that’s been carefully vetted.”

There can also be unexpected sticking points in a negotiation.

“I’m surprised, but sometimes health insurance is the make-or-break point when you wouldn’t expect it to be,” Jordan said. “People are very protective of their coverage.”

But whatever the details are, it’s important to spell them out as clearly as possible. Ambiguity is a sure path to trouble.

“There isn’t always a total meeting of the minds [on what the language means],” Jordan said. “One party believes that he or she is going to get X, and the other believes the executive is going to get Y. They’re not reading the language the same way.”

Keep Up With Trends and Legal Changes

Standard compensation and benefits change over time and in different industries. In recent years, for instance, companies have gotten much less lenient in what constitutes “good reason,” which allows an executive to quit but still take advantage of a severance package, according to Safra.

“There’s a general consensus among companies that you don’t want to give someone the chance to just walk away and collect severance,” he said. “Some companies just say at the outset, ‘We don’t want "good reason" at all.’”

Some changes are market-driven, while others can be driven by changes to the law. Recent changes to the tax code have put executive compensation attorneys into new waters on many issues. Among other changes, companies can no longer write off moving expenses for an executive, and performance-based compensation is no longer deductible above $1 million.

“I think that employers are looking overall at the compensation package [in light of tax law changes],” Jordan said. “There are a lot of items that are in no man’s land and we’re not sure what will be done. … It’s all new and we’re all sort of feeling our way.”

Meanwhile, some changes reflect larger cultural considerations or major events. After 2008, there was a lot of thought that went into changing compensation packages to avoid incentivizing excessive risk-taking, Safra said.

“That stuff is continuing to evolve,” he added.

More recently, increased focus on sexual harassment has made some companies take a look at their policies. Others have started enforcing existing policies more consistently.

“I think that there has been a concern about harassment for some time,” Jordan said. “I suspect that many are tightening up on the enforcement of their policies. And I think top executives were probably insulated from that, and now there’s a sensitivity that the policy applies at all levels of the company.”

Contracts may be affected as well, according to Safra.

“I think we’ll start to see trends in the definition of cause that give companies a little bit more flexibility, that when someone’s become a reputational problem for the company, to get them out quickly,” Safra said. “Some have already gone in that direction.”

Review Existing Contracts

Even if you build the perfect package, nothing stays perfect forever.

Experts say that it’s important to revisit deals and contracts over time — and especially to make sure that any packages the company inherits through mergers are sound.

“When you write a contract, you try to anticipate, but circumstances change,” Jordan said. “The law changes. The world changes. You can’t always anticipate every eventuality.”

Often, this is related to the question of parity — whether, over time, some executives have gotten sweet deals while others have been left behind.

Zabriskie explained that oftentimes, newcomers negotiate a good package for themselves while people who have moved up through the company or who have simply been around for a long time don’t push for the same sorts of deals.

“So you can have discrepancies,” she said, “and I think it’s really important to periodically look at your executives and say, ‘Does everybody have a similar agreement?’ You can have people be disgruntled if they feel like all the new people get a better deal than the people who’ve been there all along.”

Inherited contracts can also present big problems, experts say. During mergers, they advise, it’s worth going over an executive compensation package and checking for trouble spots and potential points of friction with a company’s usual contracts.

However, making big changes too often isn’t ideal either. For one, it can be expensive — and it can also give off the wrong impression.

“Generally speaking, there’s a review every year, but not a restructuring every year,” Rattner said. “Often a company has a compensation philosophy that it follows. … So there’s a reluctance to restructure compensation every year because it may show that you don’t have a well-defined philosophy. It sends mixed messages to your executives.”

For contracts with built-in term length, reviewing at renewal can be good policy, experts say. And even periodically taking stock and making small changes can help avoid problems down the line.

--Editing by Rebecca Flanagan and Jill Coffey.