



SME Conference 2009

Growing Your SME in a Changing Economy

Executive Compensation Issues

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October 22, 2009

- **Meeting Shareholder Expectations: Process and Substance**
- **Transitional Challenges: Change of Control Agreements and Transaction Bonuses**
- **Incentive Plans for Troubled Times: Pay for Performance Round 2**

- **Compensation decisions → Board cannot rely on management**
- **Requires:**
 - > Good process
 - > Quality decision-making
 - > Communication
 - > Independence and independent advice
 - > Stress-testing of compensation

- **New compensation disclosure rules for public companies**
 - enhanced disclosure
 - focus on design making and rational
∴ better compensation decisions
- **Say on Pay**

- **Volatile market = change**
- **Mergers, acquisitions, divestitures**
- **Difficult to keep management**
 - > focused
 - > retained
 - > motivated
 - > aligned with shareholders

Challenges



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Transitional Challenges

- **Change of Control Agreements**
- **Transaction and retention bonuses**

Change-of-Control Agreements

- **Types of agreements**
 - > double trigger
 - > single trigger
 - > walk window
 - > simple severance

Change-of-Control Agreements

- **Key definitions**
 - > change of control
 - > good reason
 - > compensation

- **Retention and Transaction Bonuses**
- **Consider in context of other employment arrangements**
 - > Severance and Change of Control Protection
 - > Treatment of Equity
- **Focus on what is needed for retention**

Retention Bonus

- > payment made after transaction
- > not paid if # fired for cause or resign
- > usually fixed \$ amount or % of salary

Amount

- > enough to retain most key people - keep employees from “looking” or leaving
- > different amounts for different levels, whether key to transaction
- > implement immediately prior to announcement

- **Payment made after transaction**
- **Designed to motivate key transaction players to increase price for shareholders**
- **Creates alignment with shareholders**
- **Choose key players carefully**
- **Consider in context with other compensation**

- **% of sale price**
- **% of sale price over target price**
- **↑ bonus based on achievement of timing or other targets**
- **Implement prior to announcement of transaction**
- **Disclosure obligations**
- **Retention features**

Two types of equity-based compensation

> Leveraged

- options
- stock appreciation rights

> Whole Share

- share purchases and grants
- tax-effective whole share grants – RSUs & DSUs & PSUs

Options, SARs and phantom equity most common for SMEs

Essential terms

- > exercise price
- > in-the-money
- > underwater
- > stock appreciation right

Options for Private Enterprises

- **Exercise price escalation**
- **Above FMV exercise price**
- **Vesting based on the achievement of other performance criteria**
- **Restrictions on exercise until main shareholder cashes out (IPO, third party sale)**
- **Valuation mechanism**
- **Company right to call shares**

- **Right to participate in the value of the business**
- **Vest based on:**
 - > time (RSUs)
 - > performance criteria (PSUs)
- **Performance targets \uparrow or \downarrow number of units**
- **Allows focus on criteria in addition to share price**
- **Currently most popular public company compensation**
- **Current Economy - Double Whammy**
 - > \downarrow vesting
 - > \downarrow share value
- **Private companies prefer options**



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