

Client Alert

Congressional Hearing and Report on Executive Pay and Compensation Consultants

Congressional Committee Conducts Hearing and Issues Report

On December 5th, the U.S. House of Representatives' Committee on Oversight and Government Reform issued a report titled, *Executive Pay: Conflicts of Interest Among Compensation Consultants*¹ (the "Report"), and held hearings on the matter.

The hearing and report were a follow-up to the investigation launched by the Committee last spring when it requested detailed information about multi-service compensation consultants' relationships with their FORTUNE 250 clients regarding executive compensation advice.

Key Factual Findings of the Report

The key factual findings of the Report after reviewing the responses of the multi-service compensation consulting firms are:

- Over 100 of the largest 250 public companies retained compensation consultants who had significant conflicts of interest (*i.e.*, the consulting firm was also paid by management to do non-executive compensation work).
- The average fee ratio of non-executive compensation services to executive compensation services was 11:1 (\$2.3 million of total fees vs. \$220,000 of executive compensation services).
- In 2006, more than two-thirds (67%) of companies with conflicted consultants did not disclose the conflict. In 30 of these cases, the consultant was branded "independent" in the company's Compensation Discussion & Analysis section of the proxy.
- In 2006 the median pay of the CEOs with conflicted consultants was 67% higher than the median of CEOs with non-conflicted consultants.
- Pay escalation from 2002 to 2006 at companies with conflicted consultants was twice as fast as that at companies with non-conflicted consultants.

Possible Outcomes

We believe there are several possible outcomes as a result of this focus on the nature of the relationship a compensation consultant has with a public company:

- Most likely is a minor change to require proxy disclosure of the fees paid to consultants to clarify the breakdown between executive compensation and other services,
- A possible imposition of a uniform standard of "independence" with the result being companies can only refer to their consultants as "independent" if the consultant meets the criteria set forth in the definition, and

¹ Available on the website of the U.S. House of Representatives' Committee on Oversight and Government Reform at: <http://oversight.house.gov/story.asp?ID=1643>

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- While considerably less likely, there is a possibility for a ban on the ability of conflicted consultants to serve Compensation Committees (similar to the prohibitions imposed on audit firms under Sarbanes-Oxley).

Conclusion

While no one can know what precisely will result from the Congressional Committee's interest and activity regarding executive pay and compensation consultants, we can be sure that executive pay will continue to be focused on by Congress, shareholders, the media, corporate governance experts and others. In particular, the independence of the consultants advising on executive pay matters should continue to be spotlighted. As a result, we expect the dynamic processes which have shaped and molded current thinking and discourse regarding best practices involving executive compensation and compensation consultants will continue to evolve and develop.



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