Keynote Remarks: "Tackling Your 2014 Compensation Disclosures: The Proxy Disclosure Conference"– sponsored by TheCorporateCounsel.net and CompensationStandards.com

Transcript: John Olson on "The Risks of Not Shooting Straight"

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September 23, 2013

Thanks very much, Broc, I appreciate being here again. I was here ten years ago, as Broc said, and it's wonderful to be back. I've been in a quite a few other places in between, San Francisco a few times and Chicago and New Orleans with you, but this is home for me and so welcome to Washington.

This is the town where our principal local product is hot air and where our Congress actually specializes in bicycling backwards - if it moves at all - so it's an unusual town but it's a lot of fun to be here. You wouldn't think of Washington as being a center for concern about the topic you're here to talk about for the next few days, which is compensation and disclosures about compensation.

But in fact as you know all too well, this is the place where the rules get made. I want to talk a little bit about the rules that have been made, but I also want to talk about what I see as our task as advisors to boards and senior management in dealing with this issue.

We've come a way now since I spoke to you ten years ago. My concerns then were how compensation appeared, not just to shareholders, but to all those who observe the corporate form in America, to those who were losing, I thought, some faith in the business community, particularly big business, because of a couple of things that I thought were correctible.

One was what I called at the time: planes, trains and automobiles. And the planes and automobiles were the perks which were so common then, and are less common now, I am happy to say: the free use of corporate jets by senior executives and their families without much accountability; the round-the-clock car services and security services for people who are paid $3 million or $4 million or more dollars a year who might, one would think, be able to afford their own cars and drivers and security services.

And when I talked about trains, I was talking about the gravy trains, in those days rather commonly in place, following retirement.

These very lavish post-retirement benefits that went on, not only for senior executives, CEOs, but also for their widows or widowers. These included deferred compensation which is all very well and good. We have that in the law firms as well, we call it contributions to our capital account. The difference from senior executives in those days and to some extent still, was that our deferred compensation generally bears no interest whatever. So basically, we're losing money on the capital contribution every year, but it's our investment in the firm, whereas senior executives in too many companies were receiving well above market interest rates that were guaranteed, so that they were actually guaranteed a return on their deferred compensation that none of their investors could attain or be assured of on their equity investments.

And I thought then that those planes, automobiles and trains were giving corporate America a black eye. I'm happy to say that much of that is gone. However there are concerns that still arise even though the eras of planes and trains and automobiles is gone.

A raft of SEC disclosure changes have brought about those changes in our environment. We have, as you well know, all kinds of additional disclosure about compensation; we have the CD&A that we were just beginning to think about seven years ago.

We've got disclosures about advisors, about the independence of compensation committees, and of course, very importantly, we have Say-on-pay. And Say-on-pay has now been around with us for going on three years, and has had an impact, at least on the margin.

Relatively few companies, as you had know, have lost Say-on-pay votes, but when they do it is embarrassing and possibly results in at least some exposure to litigation, if not ultimate liability.

So we have an environment that's been changed by those regulations, by the Dodd-Frank Act, now being implemented by the SEC. Probably the silliest requirement of Dodd Frank is now out in proposal form as of last Wednesday and that is the pay ratio disclosures requiring that companies publish the maximum compensation of the CEO, the total compensation as shown on the comp table, and then compare that to the median compensation of all of the employee base.

This is a ridiculous requirement designed to stir up popular anger, I think that's the case with that provision. Maybe Congress will eventually do away with it, although, given the inactivity of Congress, I doubt it.

But I think this provision makes a point that we need to bear in mind and that is that the corporation is the result of a social compact between society, as represented by our government, and those who manage and invest in the corporation.

This goes back to the royal compacts and charters that were given to the great companies that opened up exploration around the world from Western Europe, which includes some of the organizations that created the states that we live in.

The corporation has always had, and I think we tend to forget this, a public purpose; a bargain has been struck between those of us as citizens and the government that represents us and investors and managers.

And the bargain is: that this corporate vehicle which has been the engine of so much of our economic growth and which has made the American capital system the envy of the world, as we have perfected this instrument I think better than anyone, is this:

We made corporations easier to form, easier to understand, easier to invest in, better regulated, traded on markets that are better regulated and more transparent than anyone else, and that's all good. But what has happened and I see it still happening despite Dodd Frank, despite the SEC's new rules, despite our best efforts at disclosure, is that the public is losing confidence in the integrity and the legitimacy of this incredibly creative central instrument of our capital system.

That troubles me greatly, it troubles me as a law professor, it troubles me as somebody who's been practicing law by next June for 50 years, and it troubles me as someone who has the opportunity to be in boardrooms and talk to directors all the time. I can tell you it is bothering the members of your boards of directors.

They're not feeling as good about themselves, even when companies are doing reasonably well, as they used to. They're feeling beleaguered; they're feeling unfairly criticized: they're saying what is it that is causing this constant criticism? You read it in the press, you hear it by politicians, and you see it in election campaigns: corporations have become whipping boys – whipping girls and boys.

So what do we do about it? Well I think you have an opportunity, you as advisors have an opportunity, and that is to help to explain why compensation is what it is, but also and, very importantly, as advisors to those who are in management, are in the boardroom - an opportunity to help them think through how the plans they're coming up with are going to be understood and received by a critical public.

If we don't get it right, if we don't have an environment where our citizenry, not just employees, not just investors, but communities, voters, your relatives and mine, our neighbors, have confidence in America's companies and those who manage them, if the view of the citizenry is that corporations are being managed primarily for the greed and aggrandizement of the managers, that historic social compact that created this wonderful engine of our economy is going to be broken and we're going to see something we've seen in other countries: Companies that are heavily state run, regulation that is going to stifle innovation, a loss of confidence in our economic system.

We are coming out of a very, very deep recession, as you all know we're making progress slowly. But what do we hear? We hear that the greedy folks that run the big banks and other big companies were getting paid throughout this recession, and are still getting paid very well, even though they take a little nick now and then when something goes seriously wrong, while the rest of us have yet to recover the value of the investments that we had at the beginning of the recession. That's not a scenario that we want to live in.

So, I think it's important not just to say, "well I want to do what ISS or Glass, Lewis requires to avoid a negative Say-on-pay recommendation," or "I want to talk to my large shareholders to be sure they agree with our approach to compensation." These are important things to do. But we also need to step back and take to heart some of the lessons that our dear friend of many years Jesse Brill taught us years ago: we haven't talked about tally sheets a lot lately, we haven't talked about total compensation.

We need to think about those things and get away from just marking up last year's CD&A. We need to start thinking about what are we telling, not just investors, not just those mischievous activists that we find annoying at times and worry about, but what are we telling the community, the nation that we live in about how we're going about our business, and, more importantly in your area and mine, how we're perceived as treating all of the constituencies that the corporations that we advise and serve, as opposed to a small group of important senior managers, who, in the eyes of most of our fellow citizens, in many cases are being over-compensated for what is not always superior performance.

We’ve got to get away from the guaranteed bonus; we’ve got to get away from the too easy target for a stock option or restricted stock award; we’ve got to continue to get rid of the annoying things that look so bad; we’ve got to get away from related party transactions which make no sense (and there have been a number of situations recently where we seen those and companies try to justify them in various ways: "Well this person is so valuable, he’s the founder," or, "she’s so critical").

You know that doesn’t wash and we have a responsibility as advisers to tell our clients that that is the case. We need to tell them that it’s in their interest, if they want the enterprise they serve to survive and prosper, to be respected, to have compensation that is understandable, that is transparent, that is clearly related to performance in a meaningful way.

And if we don’t do that, I think we have a real risk that the capitalist system as we know it and the corporate engine that has been so terrific in our economy for the last 150 years, is going to be altered in ways that are going to be very damaging to innovation, very damaging to economic growth and ultimately a great loss to our society.

Thank you very much.