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BOARD COMPENSATION IN TIMES OF DISTRESS: PREPARING FOR THE ROAD AHEAD

BRIAN L. CUMBERLAND AND J.D. IVY
Alvarez & Marsal

When companies prepare for a potential restructuring, adjustments to compensation programs for executives and key employees are common practice. However, adjustments to non-employee director compensation are often overlooked.

Normal-course board compensation is comprised of two elements – (1) cash retainers (including an annual board retainer and committee retainers) and (2) an equity retainer (typically restricted stock that vests if the director remains on the board for 1 to 3 years from grant). At the time of a potential restructuring, however, previous equity awards issued by the company typically have little to no value, and the company may not have enough available equity to properly compensate its board members.

According to the 2018-2019 NACD Public Company Governance Survey, the average public company director's time commitment equates to nearly 245 hours each calendar year. During, and in preparation for a restructuring, the workload for board members significantly increases. This is particularly true during the early stages of a restructuring when many important decisions require the board's timely attention. The increased time commitment is one factor that should be considered when evaluating board compensation practices and levels during a restructuring.

Moreover, in a bankruptcy setting, board members are also likely working themselves out of a job, as most board members do not continue service after the company emerges from bankruptcy with the new owners or the company is sold. Our experience has shown there is a 98% board member turnover. These factors highlight the need to appropriately compensate essential board members in order to maximize the value of the company over the course of the restructuring process.

Common Changes to Board Compensation

Prior to making any changes to compensation, boards should evaluate market levels of pay by benchmarking compensation at similar companies. Appropriate compensation is essential to maintaining the directors' focus during a time of distress and increased workload.

Benchmarking director compensation also provides assurance to companies that their board members are being compensated fairly and within market, which may reduce the company's risk associated with utilizing out-of-market pay practices.

Conversion to Cash Compensation

As a company approaches a restructuring event, equity compensation generally does not provide an appropriate incentive due to its diminished value. The most common process boards undertake during this time is to conduct a market analysis to ensure competitive levels of compensation and then convert the board compensation to a fully cash-based program. For example, a company with a $100,000 cash retainer and a $150,000 equity retainer would convert to a $250,000 cash retainer (see diagram on next page.)

Normal Course Compensation | **Restructuring Compensation**

Cash Retainer ($100,000)

Equity Retainer ($150,000)

Cash Retainer ($250,000)

Adjustments to payout timing are also considered in order to maintain the directors' focus throughout the restructuring process. For example, companies with programs that pay out annually often convert into a quarterly program that is payable in advance. Additionally, the directors' increased time commitment should be considered when evaluating potential changes to go-forward compensation, as additional compensation may be warranted.

Special Restructuring Committee

In certain cases, the board will form a separate restructuring committee in anticipation of the specialized tasks associated with the restructuring. Or, a board member might be appointed the Chief Restructuring Officer ("CRO"). In exchange for service on the special committee or as a CRO, additional compensation commensurate with their additional duties and extraordinary workload is warranted. Compensation for service on a special restructuring committee or a CRO vary widely based on the company's needs and the individual director's contributions.

Return to Meeting Fees

For steady-state companies, the general market trend has been for boards to move away from paying per-meeting fees, instead focusing on a fixed retainer structure. However, in a restructuring context, the use of meeting fees may be more appropriate as a means to reflect the additional workload during the restructuring process. However, a fixed retainer, with no meeting fees, simplifies the administrative process and removes the challenge of determining what is considered a "meeting."

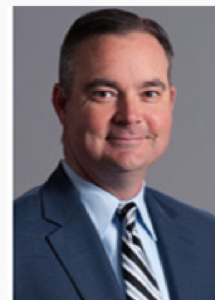
Conclusion

When approaching a potential restructuring, companies should ensure board compensation plans are fair, reasonable, and aligned with market practices. Not only is it best practice but doing so demonstrates a company's commitment to its board and accountability to stakeholders during the restructuring process.

ABOUT THE AUTHORS

Brian L. Cumberland
Alvarez & Marsal

Brian Cumberland is a National Managing Director with Alvarez & Marsal, and leads the Restructuring Compensation Practice. Mr. Cumberland has assisted in over 100 restructuring clients with designing Board Compensation, Key Employee Incentive Programs ("KEIPs"), Key Employee Retention Programs ("KERPs"), and Emergence Grants. Mr. Cumberland received a bachelor's degree in business administration from the University of Texas and a juris doctor from St. Mary's School of Law. He also received a master of law degree in taxation from the University of Denver.



J.D. Ivy
Alvarez & Marsal

J. D, Ivy is a National Managing Director with Alvarez & Marsal, and leads the Compensation & Benefit Practice. Mr. Ivy assist in designing compensation programs for executives and members of a company's board of directors, as well as bankruptcy compensation (Key Employee Incentive Plans (KEIPs) and Key Employee Retention Programs (KERPs) and emergence grants). Mr. Ivy received a bachelor's degree in accounting from Abilene Christian University and a master's degree in business administration from Texas Tech University.