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Bonuses rile many but have their uses

Amid AIG fallout, two courts back Nortel payouts

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It's the bonuses, stupid.

As the economy bleeds jobs and government bailouts for the private sector balloon, taxpayers and investors have become increasingly outraged about bonuses paid to employees at distressed companies – particularly those viewed as having had a hand in sparking the global downturn.

Over the past few weeks, battered insurer American International Group Inc. has become a lightning rod for criticism after it paid out \$165 million (U.S.) in bonuses to current and former employees after receiving \$173 billion in U.S. government bailout money.

Now, some U.S. lawmakers are calling on Washington to halt retention bonuses for hundreds of executives at troubled mortgage giants Fannie Mae and Freddie Mac.

Toronto-based Nortel Networks Corp., meanwhile, won court rulings in both Canada and the United States yesterday that allow eight senior executives to share in an already-approved \$45 million bonus pool, even as the maker of telecom gear struggles to exit bankruptcy protection.

Some of Nortel's U.S. creditors had held up the approval process because they were seeking projections for the 2009 fiscal year, while some former employees had protested paying bonuses to senior executives when the company isn't honouring severance payments for as many as 1,100 laid off workers.

"These are obviously well-compensated individuals that are now being paid additional millions of dollars to stay on and do the jobs they already agreed to do," said Eli Karp, a Toronto lawyer who is representing about 60 of the former Nortel employees.

"Our clients have lost their jobs and aren't getting the severance promised to them."

Nortel, with about 30,000 global employees, including about 6,000 in Canada, stopped paying severance to former workers after it filed for protection from its creditors in mid-January with about \$2.4 billion in cash on its balance sheet. It has since announced plans to shed another 3,200 workers.

But while granting big executive bonuses when a company is struggling for survival strikes many as unfair, experts argue there are legitimate reasons for providing performance-based incentives to a firm's key personnel during a crisis.

"I think there has been an overreaction to this whole issue," said Rick Powers, executive director of MBA programs at the University of Toronto's Rotman School of Management. "An integral part of an executive's compensation is meeting performance targets.

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Incentive Compensation

"The problem is that companies have not been transparent with their compensation policies."

While Powers isn't a fan of retention bonuses – giving employees money, in other words, simply for sticking around – he said performance-based bonuses are often a critical tool for companies mired in difficulties to align the goals of key managers with those of creditors and other stakeholders.

The key, according to Powers, is ensuring that the targets are real and achievable, and that bonuses are awarded only to employees who deliver results.

In the case of Nortel, the \$45 million bonus program is to be paid out to close to 1,000 executive and mid-rung employees if certain targets are met during the company's restructuring.

CEO Mike Zafirovski, who took home a salary of \$1.3 million in 2007, the most recent year for which figures are available, is not included in Nortel's 2009 bonus program.

But eight other senior executives, including three in Canada, could collectively receive as much as \$7.3 million in bonuses if they meet cost-cutting targets and other parameters designed to make Nortel more focused, as well as achieving the approval of any restructuring plan by creditors and the courts.

"It is important to note that the vast majority of employees at all levels are already on a quarterly incentive plan aligned to the short-term goals of company," Nortel spokesperson Mohammed Nakhouda said.

"Of those employees, we have identified a few hundred additional individuals to be part of a separate incentive program, including some executives, to ensure that key employees with specific skills and experience remain in place as we deliver on the restructuring."

Nortel did not award any bonuses to employees under its annual incentive plan for 2008.

The real rub for critics, however, is AIG.

Its bonus payouts sparked the ire of U.S. President Barack Obama, who sharply condemned management's "recklessness and greed."

In some cases, the bonuses were paid to employees who worked in AIG's financial unit, the same division responsible for nearly bringing the insurer down by making bad bets on derivatives.

The U.S. House of Representatives has since voted to slap a 90 per cent tax on employee bonuses at AIG and any other companies in receipt of \$5 billion or more in federal bailout money.

AIG, deemed too big to fail, recently reported a fourth-quarter loss of \$61.7 billion, the largest in corporate history. It has been rescued four times on the taxpayers' dime after major missteps involving credit-default swaps.

The insurer sold those derivatives – a type of insurance on debt – to financial institutions around the world. The problem was that some of the debt securities they insured were tied into America's hyper-vulnerable subprime mortgage market.

When the credit crunch sent the debt instruments plummeting in value last year, global banks wanted to collect on their insurance. AIG, however, did not have enough money to cover all the payouts and the U.S. government was forced to step in to prevent the insurer's collapse.

Bonuses, to a lesser degree, have also struck a painful chord with Canadian taxpayers.

Canadian Broadcasting Corp., which is facing a budgetary shortfall, found itself embroiled in a fracas this week when it was revealed the public broadcaster still plans to pay its executives half of their annual bonuses even as it freezes their salaries in the next fiscal year.

That decision to preserve part of the executive payouts comes at a time when the Crown corporation's rank-and-file employees are bracing for layoffs over the coming weeks.

Most regular CBC employees are not paid bonuses. Some staff, such as on-air personalities, do receive additional remuneration. Many of those employees have been informed that their bonuses will not be renewed, says the Canadian Media Guild, which represents thousands of CBC employees.

"If there is pain to be had, it has got to be equally shared by all," said guild president Lise Lareau in a telephone interview.

"We are anxious and willing and working with the CBC to do whatever is reasonable to alleviate layoffs and program cuts."

The issue of executive bonuses was reportedly raised at meetings in Ottawa yesterday between the CBC and union representatives.

CBC officials did not return calls seeking comment yesterday.

With files from the Star's wire services