

## Examples of Compensation Disputes:

### Injury Dispute

A claimant is partially incapacitated as a result of an injury and as a result is relegated to working in a reduced role which pays less compensation than before the injury.

### Shareholder dispute over compensation

Shareholders of a closely-held company who are not employees of the enterprise allege that the active employee shareholders receive too much employment compensation from the company, therefore reducing their dividends .

### Termination of employment dispute

An executive is terminated and receives a severance package that the departing executive views as inadequate. The claimant may allege that terms and conditions of employment were modified shortly before the termination. Conversely, the company may charge that the executive was able to increase his/her compensation in anticipation of a potential severance event.

### Marriage breakdown dispute

In a marital breakup situation, the fair value of an executive's outstanding stock options and unvested equity awards need to be determined for asset splitting



## Providing Expert Witness Advice: A Compensation Consultant's Perspective

Law firms frequently require professional compensation consulting expertise in order to assist their clients in negotiating fair settlements. Typically lost income and/or potential unrealized compensation need to be estimated for a predetermined period of time based on the most appropriate data sources, so that the magnitude of the financial claim can be established. It should be noted that an expert witness opinion must meet certain legal standards in order to be acceptable in a court of law if a trial becomes necessary.

### Overview

While an infinite array of case types may need a compensation value opinion, most fall under four major categories (listed on the left) based on McDowall Associates' years of experience in this area.

McDowall Associates is unique, not only because we are a medium-sized Canadian-owned and operated compensation consulting firm, but also because we regularly provide expert witness compensation services to law firms and their clients<sup>1</sup>. In addition, we have provided expert opinions on numerous cases of these types for both claimants and respondents. Our expertise in this area complements the other consulting services we offer to clients, such as Ontario pay equity advice.

While expert witness work requires compensation professionals to use customary skills and methods, it also requires skills and approaches that are not normally employed in other consulting assignments, which typically focus on compensation arrangements for individual *positions*, rather than for individual *employees*.

1 - Most of the larger compensation consulting firms have policies that prevent them from providing expert witness advice in legal disputes

## Each Expert Witness Report Must:

- Not be influenced by the nature of the litigation
- Provide an unbiased opinion
- Not advocate for the client's case
- State the facts or assumptions on which the opinion is based
- Disclose any limitations in the research
- Include a signed acknowledgement of the expert's prevailing duty to the court.

Providing expert opinions in these matters has taught us to stretch our thinking about traditional compensation analysis and review. Market data in these cases is used to estimate earning potential or accumulated employment earnings over an extended period of time, resulting in more information and caveats be attached to the information than we normally are required to report to a client. All assumptions used must be clearly identified and articulated to ensure that both sides of the dispute understand the scope and the limitations of the analysis, especially when the required information is not readily available.

Compensation professionals may not be aware that an expert witness's report must meet certain mandatory requirements in order to be acceptable in a court of law<sup>2</sup>. In particular, the opinion must be entirely objective, not be influenced by the legal matter at issue, be evidence-based, and not advocate for the expert witness' client. In addition, the expert must sign a form<sup>3</sup> acknowledging that his or her ultimate duty is to the court, not to the client.

## Each Expert Witness Case has Unique Aspects

The following examples illustrate the need for us to be able to think outside the traditional compensation box when being asked to provide expert witness opinions:

*Analysing Multiple-Years of Historical Data:* In order to verify whether a client's pay structure is market competitive, compensation professionals usually only need to review the current year's compensation market. Many legal disputes, however, require us to examine multiple years of market data since a claim may involve damages resulting from an event spanning a number of years. These multi-year reviews often show year-over-year market volatility in compensation results, usually involving fluctuations in annual incentive compensation payments and/or long term incentive awards and payouts. Economic conditions over the study's time span can swing the year-to-year results significantly. For example, the economic crisis of 2008 has impacted executive compensation magnitudes significantly, especially for financial sector executives.

*"What-if" Scenarios:* Some expert witness assignments require us to project how much terminated employees would have earned had they continued employment, some times over a long period of time depending on the nature of the situation. Examining the relationship between company/industry performance and pay is the most straightforward way to calculate these estimates. However, when a multi-year analysis is required for a developing executive, potential career progression must also be taken into account. Movement along a salary range must also be modelled.

<sup>2</sup> -Rules of Civil Procedure, Rule 53.02(2.1)

<sup>3</sup> -Form 53 (effective January 1, 2010)

## Fully Independent Experts

McDowall Associates is a fully independent consulting firm offering a complete range of advisory services for Boards and management.

## Strategic & Evidence-based Approach

Providing market intelligence based on research is foundational to the consideration of alternative strategies.

## Subject Matter Experts

Experience matters! Our associates have in-depth knowledge of executive compensation and related areas of practice including Expert Witness Consulting.

*Estimating Owner/Entrepreneur Compensation:* Compensation for entrepreneurs can vary considerably over the years and it can be delivered in ways other than employment income. Owner/operators and their accountants annually need to determine whether it is more tax effective to receive income as tax deductible pay or in after-tax dividends, resulting in significant year-to-year differences in actual compensation payments. Compensation market surveys do not consider earnings delivered other than through compensation income instruments. Compounding this issue is that entrepreneurs do not always assume traditional corporate roles, especially when multiple owners are actively engaged in various aspects of the company's operations. The roles we are asked to review often are not neat matches to the positions found in typical compensation surveys, even though the same titles may be used. Our task is to adjust actual entrepreneur income levels from various sources for the services they actually provide to standardize their employment income to the compensation reported in compensation surveys and to ensure we compare to positions with a similar level of responsibility.

## Conclusion

As compensation experts we tend to look at annual compensation market information in aggregate as part of the normal course of our consulting work. Our goal usually is to provide employers with market information at a specific organizational level or levels. We rarely are asked look at the compensation of individual employees in isolation. We are usually asked to generalize even further by presenting our results by organizational level or grade - the sheer size of the workforce of most of our clients forces us to think more in terms of organizational groups than for individuals.

Expert witness assignments provide us with the opportunity to examine compensation as it relates to an employee's career progression over an extended period of time. It allows us the opportunity to examine the workings of a variable compensation plan assuming various economic and performance scenarios. Moreover, these assignments require us to be able based on past experience to explain our work in non-compensation jargon to an audience that is trained to thoroughly question and challenge all witnesses, including compensation experts.

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