

## >> COVID-19 ALERT

# COVID-19 and Executive Compensation

### THE BOTTOM LINE

- >> In light of this unprecedented scenario, employers should closely review their executive compensation arrangements and proactively address some of the issues that will undoubtedly arise. The correct method for addressing these complex issues will depend on the employer's industry, business objectives and the specific impact of the coronavirus-crisis.
- >> Employers should consult with executive compensation counsel to understand their options for amending or potentially redesigning their executive compensation programs.

Now that the sweeping effects of the coronavirus pandemic are starting to settle in, employers should be prepared to address executive compensation issues that will arise with respect to top tier management and broader talent throughout the organization.

Executive contracts, equity incentive compensation and performance-based compensation programs may all be impacted by the abrupt economic downturn and cash flow issues facing many businesses.

Below are executive compensation considerations that employers will want to address in the days and weeks ahead.

### SALARY CHANGES

Employers facing downturns in their business may consider reducing employees' salaries. Generally, employers may not reduce salaries without providing notice to employees. In addition, before reducing salaries, employers should review the employment agreements that they have entered into with their executives.

If an employment agreement promises an executive that they will be paid at a certain salary level, the employer will need to obtain the executive's consent to be paid at the lower salary. If an employee does not wish to consent but the employer nevertheless desires to implement a salary reduction, the employer will need to consider if the reduction triggers "good reason" for the executive to resign and be entitled to severance. Some employment agreements expressly permit executive salary reductions in connection with an across the board reduction in salaries.

### SALARY DEFERRAL ARRANGEMENTS

Certain salary deferral arrangements are already making headlines, with major national companies announcing salary deferrals amongst their highest ranking executives in an effort to strengthen the company's cash position. Salary deferral arrangements could present technical issues under Section 409A of the Internal Revenue Code (Section 409A), which significantly limits the ability of executives to defer salary unless strict requirements are met. Deferring salary to later in the same tax year (or up to March 15 of the following tax year) will not violate Internal Revenue Code Section 409A but will require a written salary deferral agreement.

Depending on how a short-term salary deferral agreement is drafted, an employer experiencing financial difficulty may be able to further delay payment of the deferred salary beyond March 15 of the following year without violating Section 409A.

## PERFORMANCE-BASED COMPENSATION

Performance goals for 2020 performance-based compensation, which include annual bonuses, long-term incentive plans (LTIPs) or performance-vesting equity awards, will likely be unachievable for many businesses due to the current economic conditions. If performance goals are no longer reasonably achievable, the company's performance-based compensation programs will not be properly incentivizing executives, who, in turn, may not realize the value from these arrangements.

Employers should consider reviewing these arrangements to determine the discretion they have to modify performance goals.

## EQUITY COMPENSATION

Similar to performance-based cash compensation, certain types of equity compensation awards may no longer have much value due to the market conditions. For example, if a company's per share value has gone down, stock options may have an exercise price greater than the current fair market value (referred to as being "underwater"). If depressed stock prices continue for some time, eventually companies may wish to consider repricing stock options. Another alternative is to cancel underwater options and replace these awards with a different type of equity interest, such as restricted stock.

As the COVID-19 crisis unfolds, companies will want to turn their attention to reviewing equity compensation arrangements and possibly reconsidering the types of equity awards granted.

## SEVERANCE ELIGIBILITY

As many businesses face the realization of the need to place employees on leaves of absence or furlough, or terminate employment entirely, employers should be aware of their severance obligations under employment agreements or severance plans. Additionally, equity awards may provide for accelerated vesting upon termination. A leave of absence, furlough or other reduction in services may or may not be a "termination" or "separation from service" as defined in the applicable documents.

It is important to review these documents closely to understand the employer's obligations.

## DEFERRED COMPENSATION PLANS

With companies looking to cut costs and employees looking to increase their take-home pay, we have already seen companies facing issues with their deferred compensation plans. Deferred compensation plans are subject to the rules under Section 409A which limit the ability to make changes to deferred compensation arrangements and require a detailed review of plan documents and regulatory guidance when changes are being considered.

Employees who have made elective deferrals under a company's deferred compensation plan for 2020 may wish to withdraw their election due to the crisis but will be unable to do so in many cases, as Section 409A requires such elections to be irrevocable as of December 31, 2019.

One exception under which an employee's deferral election may be revoked is if their circumstances rise to the level of being an "unforeseeable emergency," as defined under Section 409A. An employee who has an "unforeseeable emergency" may also be entitled to receive a distribution of at least a portion of their account balance under the plan.

Unlike 401(k) plans, no loans are permitted from a deferred compensation plan.

## RETENTION AGREEMENTS

Now more than ever, it may be critical for a company to retain its key executives. With all of the turmoil resulting from the crisis, key employee turnover can be particularly problematic. Employers may want to consider putting in place retention arrangements to incentivize key executives to remain employed through certain dates or the achievement of certain benchmarks.

## COMMISSION ARRANGEMENTS

Some commission plans pre-pay commissions to employees once a deal or contract has been signed, even

before the company receives full-payment from the client or customer. Companies should closely review their commission arrangements to understand the company's rights to clawback commissions in the event clients become unable to pay for their services.

### CORONAVIRUS-RESPONSE LEGISLATION

In addition to the practical and business considerations for reviewing your company's executive compensation arrangements, Congress has proposed executive compensation limits for certain businesses that will receive federal financial aid.

Specifically, on March 27, President Trump signed the Coronavirus Aid, Relief, and Economic Security Act

(the CARES Act) into law which provides that national security-critical businesses, air carriers and related businesses must limit executive compensation when obtaining certain loans under the CARES Act. The CARES Act requires these businesses to limit compensation for employees who received more than \$425,000 in compensation in 2019, such that these employees may not receive more than their 2019 compensation during the period a government loan is outstanding and for one-year thereafter.

During this same period, executives who were paid over \$3 million in 2019, must have their salaries reduced to a maximum of \$3 million, plus 50 percent of the excess over \$3 million they received in 2019.

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