

Reproduced with permission from Pension & Benefits Daily, 127 PBD, 07/02/2014. Copyright © 2014 by The Bureau of National Affairs, Inc. (800-372-1033) <http://www.bna.com>

Negotiating Executive Employment Agreements: Cutting a Path Through the Regulatory Thicket



By WENDI S. LAZAR AND KATHERINE BLOSTEIN

Introduction*

The landscape of executive compensation has changed significantly since the financial crisis of 2008. As a result of the ensuing downturn and increased public scrutiny, executives' leverage in negotiating the terms and conditions of their employment and equity agreements has decreased. The overwhelming outcry about excessive pay from shareholders and the

public following the downturn resulted in new legislation that limits executive pay for top executives at public companies and imposes compensation restrictions and disclosure requirements on large companies generally. However, in the intervening years, the Securities and Exchange Commission still has not enacted rules implementing a significant portion of the new legislation, and therefore much uncertainty remains.¹ In addition, the past several years have seen a return to performance-based compensation, as well as a movement towards eradicating excessive guaranteed bonuses on Wall Street and among other bonus-based businesses.

Because of the ongoing need to attract and keep top talent, companies have begun adjusting to the newly imposed restrictions and, where possible, are finding creative ways to structure compensation packages for employees. Unfortunately, public opinion is not as easily assuaged. The current challenge for companies and their counsel negotiating executive agreements is to balance the company's need against potential negative public opinion. How hard and where to push in a negotiation remains a concern in order to ensure that these agreements pass muster with boards and shareholders.

Also, since 2008 employers have begun to insert clawback provisions into compensation packages and bonus payments in ways previously unseen. The enforceability of many of these provisions remains untested, and thus attorneys must negotiate agreements containing these provisions in the shadow of uncertainty.

The good news is that the economy has rebounded significantly from its lowest point during the economic downturn. Alongside that rebound, levels of executive compensation have again begun to rise, and may be poised to exceed pre-2008 levels. However, much of the legislation intended to regulate excessive compensation has not yet been implemented. A major issue for lawmakers and regulatory agencies in the coming years

* This article updates "Executive Pay: Skydiving with a New Parachute," published in 212 PBD, 11/2/11; 38 BPR 2071, 11/8/11.

Wendi Lazar (wsl@outtengolden.com) is a partner at Outten & Golden LLP, New York, where she co-heads the firm's executives and professionals practice group. She practices in many areas of employment law with a focus on executive agreements, including retention, expatriate, noncompetition, talent, severance, and compensation arrangements. Katherine Blostein (KB@outtengolden.com) is an associate in the executives and professionals practice group. The authors would like to thank Hunter Swain, who is a member of the Colorado Bar and the New Jersey Bar, and a law clerk at Outten & Golden LLP, pending admission to the New York Bar, for his research assistance.

¹ For instance, the SEC has enacted only a handful of final regulations to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). See SEC, Corporate Governance Issues, Including Executive Compensation Disclosure and Related SRO Rules, available at <https://www.sec.gov/spotlight/dodd-frank/corporategovernance.shtml>.

will be how to implement the new rules in a balanced way. Additionally, it remains unclear how the new regulatory landscape will affect compensation negotiations.

With these considerations in mind, attorneys representing executives should be aware of the most recent trends, legislative developments and regulations that will affect negotiations in the years to come.

1. Regulations Affecting Executive Compensation Since the Financial Crisis of 2008.

In the wake of the financial crisis of 2008, a number of laws aimed at governing and limiting the payout of executive compensation were proposed and enacted. Therefore, it is important for executives' counsel to be aware of recent legislation and the regulations that will affect executive compensation and to know when to seek the assistance of a tax adviser or a compensation expert.

Initially, significant limitations on executive compensation were enacted by the American Recovery and Reinvestment Act of 2009 (ARRA)² that related to executive compensation limitations for financial institutions receiving funding under the Troubled Asset Relief Program (TARP).

Approximately 99 percent of companies that originally received TARP funds have since paid off their TARP debt, and thus the executive compensation limits set out by the ARRA have become largely irrelevant.

U.S. regulators then turned to new legislation that could regulate and limit executive pay. The result was the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),³ signed into law on July 21, 2010. Dodd-Frank is broad reaching legislation that includes new rules for mortgage lending, risk management, product development, investment management, customer service/communications and executive compensation.

Specifically, Section 956 of the Act addresses incentive compensation by requiring covered financial institutions to make compensation disclosures that will enable shareholders to determine whether compensation paid to executives is excessive or could lead to "material financial loss to the covered financial institution." Although the Dodd-Frank Act was originally meant to focus on Wall Street, the executive compensation provisions aim to significantly modify corporate governance and disclosure practices for almost all U.S. public companies. The act ushers in fundamental changes in executive compensation disclosure, compensation committee independence, shareholder voting rights, and clawbacks, which will be implemented by various federal regulations over the course of the coming years.

² Pub. L. No. 111-5, amending § 111 of the Emergency Economic Stabilization Act of 2008, and extending the scope of coverage from the top five most highly compensated employees to include the next 20 most highly compensated employees, or to such higher number as the Treasury Department may determine is in the "public interest." The ARRA went so far as to revisit compensation determinations made prior to its enactment to confirm that such prior compensation determinations were consistent with TARP and not contrary to the "public interest." EESA § 111(f)(1), as amended.

³ Pub. L. No. 111-203.

a. "Say-on-Pay" and Compensation Disclosures.

On Jan. 25, 2011, the SEC adopted final rules⁴ implementing Section 951 of the Dodd-Frank Act. Section 951 amended the Securities Exchange Act of 1934⁵ by adding a new Section 14A(a)(1),⁶ the "say-on-pay" provision, which requires all public companies to present to their shareholders an advisory resolution to approve compensation of its named executive officers, as disclosed pursuant to the executive compensation disclosure rules,⁷ at least once every three years. The frequency of these advisory votes must be determined by a separate shareholder resolution no less than every six years and shareholders may elect to have the "say-on-pay" vote every one, two, or three years, with initial votes to be held on or after Jan. 21, 2011.⁸ Further, Section 951 also modified the Exchange Act by adding a new Section 14A(b)(1)⁹ regarding "golden parachute" disclosures, requiring any person making a proxy solicitation relating to sale, acquisition, or merger to include disclosure of any compensation arrangements between the soliciting person and the company's named executive officers.

Section 951 applies to all public U.S. companies, and it began to impose say-on-pay and say-on-frequency advisory votes upon "smaller reporting companies" with assets of less than \$75 million after Jan. 21, 2013. Disclosure requirements regarding "golden parachute" payments in connection with change in control transactions took effect April 25, 2011. Finally, TARP companies are not subject to the new rules while they are still under TARP reporting rules.¹⁰

Other provisions of the Dodd-Frank Act will force public companies to make specific disclosures that will likely impact executive compensation structures. For example, under Section 953(a) companies will have to make pay for performance disclosures demonstrating the relationship between executive compensation actually paid and the company's financial performance. The SEC has not yet adopted rules to implement Section 953(a).

The SEC proposed a rule on Sept. 28, 2013, to implement Section 953(b)'s CEO pay ratio disclosure requirement, which requires disclosure of the ratio of the "annual total compensation" of a CEO to the median "annual total compensation" of all other employees. The proposed rule allows employers flexibility in calculating "annual total compensation" and it will not apply to smaller issuers, foreign private issuers, and emerging growth companies. If implemented by the end of October 2014, as expected, the pay ratio disclosure requirement will first apply during the 2016 proxy season.

The SEC has not yet adopted rules to implement Section 955, which requires disclosure of whether directors or employees are permitted to hedge company securities. The SEC's rulemaking agenda indicates that it will

⁴ Securities Act Release No. 33-9178, 76 Fed. Reg. 6010 (Feb. 2, 2011).

⁵ 15 U.S.C. § 78a et seq.

⁶ 15 U.S.C. § 78n-1(a)(1).

⁷ See Item 402 of Regulation S-K

⁸ 15 U.S.C. § 78n-1(a)(2) & (3).

⁹ 15 U.S.C. § 78n-1(b)(1) & (2).

¹⁰ Securities Act Release No. 33-9178, *supra* note 4.

propose rules to implement these sections by the end of October 2014.¹¹

b. Financial Institutions and Incentive Pay.

On the heels of the SEC's adoption of the say-on-pay provisions, the federal banking agencies proposed new rules under Section 956 of the Dodd-Frank Act¹² regarding incentive compensation paid to financial institution employees. As proposed, these rules will specifically apply to all banks and financial institutions with assets greater than \$1 billion that provide incentive compensation to their employees. All "covered financial institutions" will be required to annually report incentive compensation arrangements to their primary regulators within 90 days of the fiscal year end. The definition of "covered" persons includes any executive officer, employee, director, or principal shareholder of a covered financial institution. There is no specific category of employee that is outside of the scope of the rules since they are tailored to apply to all employees whose duties expose the organization to a possibility of a material financial loss.

The proposed rules also impose heightened standards for "larger covered financial institutions," or institutions with \$50 billion or more in consolidated assets.¹³ For these larger institutions,¹⁴ the rules require that at least 50 percent of incentive-based payments be deferred for a minimum of three years for designated executives. Moreover, boards of directors of these larger institutions must identify employees who individually have the ability to expose the institution to substantial risk (in addition to executive officers), and must determine that the incentive compensation for these employees appropriately balances associated risk and

¹¹ See Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act — Pending Action at <http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml>.

¹² Incentive Based Compensation Arrangements, 76 Fed. Reg. 21,170 (April 14, 2011), jointly proposed by the federal banking agencies—the Federal Deposit Insurance Corporation, the SEC (Exchange Act Release 34-64140), the Treasury Department's Office of the Comptroller of the Currency and Office of Thrift Supervision, the Board of Governors of the Federal Reserve and the National Credit Union Administration.

¹³ The Dodd-Frank Act defines "covered financial institution" to include any of the following types of institutions that have \$1 billion or more in assets: (i) a depository institution or depository institution holding company, as defined in § 3 of the Federal Deposit Insurance Act (FDIA) (12 U.S.C. § 1813); (ii) a broker-dealer registered under Section 15 of the Exchange Act (15 U.S.C. § 78o); (iii) a credit union, as described in Section 19(b)(1)(A)(iv) of the Federal Reserve Act; (iv) an investment adviser, as defined in Section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. § 80b-2(a)(11)); (v) the Federal National Mortgage Association; (vi) the Federal Home Loan Mortgage Corporation; and (vii) any other financial institution that the appropriate federal regulators, jointly, by rule, determine should be treated as a covered financial institution for these purposes.

¹⁴ The proposed rules define larger covered financial institutions relative to the applicable agency. For the federal banking agencies and the SEC, the definition covers those financial institutions with total consolidated assets of \$50 billion or more. For credit unions the definition applies to those financial institutions with total consolidated assets of \$1 billion or more. For the FHFA, all Federal Home Loan Banks with total consolidated assets of \$1 billion or more are larger covered financial institutions.

rewards according to enumerated standards. The comment period for the proposed rules closed May 31, 2011, but as of April 2014, the final rules had still not been published.

The proposed rules would move the U.S. closer to aspects of international compensation standards.¹⁵ The banking agencies believe that the proposed regulations would help eliminate incentive-based compensation arrangements that encourage inappropriate risk or may result in material financial losses. According to the proposed rules, each "covered" company must institute policies and procedures for incentive-based compensation arrangements that are commensurate with the size and complexity of the institution and provide annual reports on incentive compensation structures to appropriate federal regulators.

All of the regulations discussed above make clear that the days of paying excessive executive compensation unchallenged by regulators and shareholders are over. The inclusion of "say-on pay" and other provisions in the Dodd-Frank Act have caused public companies to become more shareholder driven in regard to their executive compensation policies. For example, policy guidelines used in 2011 by Institutional Shareholder Services Inc. to formulate voting recommendations on executive pay and corporate governance issues recommended annual shareholder votes on executive compensation, and today most shareholder votes are held annually. ISS's current policy guidelines include on the list of egregious pay practices single trigger change in control pay provisions, tax gross ups, and single trigger vesting of unvested equity in the event of involuntary termination.¹⁶

An attorney negotiating an employment agreement for an executive joining the ranks of a public company or a financial institution must be aware of all of these statutory and regulatory limitations, as well as proxy adviser policies and guidelines and how they will affect his or her client.

c. Tax Issues: Section 409A.

The most important tax regulation that has recently affected employment agreements is Section 409A of the tax code. The final regulations became effective on Jan. 1, 2009.¹⁷ Section 409A regulates the tax treatment of "nonqualified deferred compensation."

Section 409A provides that unless a "nonqualified deferred compensation plan" complies with various rules regarding the timing of deferrals and distributions, all vested amounts deferred under the plan for the current year and all previous years become immediately taxable (including a 20 percent penalty tax) to the employee.¹⁸ The result of these restrictions is that most of the details under a deferred compensation arrangement must be in writing and defined from the beginning of the deferred compensation arrangement (unless one of the exceptions from the regulations applies). For purposes of Section 409A, a deferred compensation plan is one that

¹⁵ 76 Fed. Reg. at 21,180.

¹⁶ See <http://www.issgovernance.com/files/2014USPolicyUpdates.pdf>.

¹⁷ Treas. Regs. § 1.409A-1 through -6.

¹⁸ Section 409A(a)(1)(A) & (B). California imposed an additional state tax penalty tax of 5 percent effective Jan. 1, 2014. See 2013 Cal. Legis. Serv. Ch. 536 (A.B. 1173) (West) (reducing the state tax from 20 percent).

“provides for the deferral of compensation if, under the terms of the plan and the relevant facts and circumstances, the service provider has a legally binding right during a taxable year to compensation that, pursuant to the terms of the plan, is or may be payable to (or on behalf of) the service provider in a later taxable year.”¹⁹ Under Section 409A, a “plan” includes an employment agreement.²⁰

With regard to short- and long-term compensation, under Section 409A, if an annual bonus is earned in one taxable year and paid in another, it may constitute a nonqualified deferred compensation plan. If an employer pays part of the annual bonus shortly after the close of the year in which the services were performed and pays the rest in a later year, the timing and nature of the payments would be subject to Section 409A and must comply with the distribution requirements under Section 409A.²¹ The annual bonus must be paid in the year the services are provided or within 2-1/2 months following the end of the employee’s tax year or the employer’s tax year, whichever is later (the “short-term deferral” rule) in order to avoid the application of Section 409A.²²

Under Section 409A, stock options and stock appreciation rights are excluded from the treatment as deferred compensation if they meet certain requirements. In this regard, a stock option must have an exercise price no less than the fair market value of the stock on the date of grant to the employee, i.e., it cannot be discounted.²³ Shares of restricted stock are not deferred compensation for purposes of Section 409A, but restricted stock units are deferred compensation that must comply with Section 409A. Other forms of equity compensation grants must be examined carefully to determine whether they fall within the statute’s definition of deferred compensation. The application of the rules to equity plans and grants can be complicated, and careful attention must be given as to how the rules apply to a particular form of equity compensation.

2. Changes in Executive Compensation Structure.

These rules and regulations have significantly changed the form and nature of executive pay. Companies are designing compensation programs that, depending on the company’s cash flow, are heavily weighted toward long-term rewards and are partially or wholly performance-based. The form and nature of incentive compensation differs across industries. However, any compensation arrangement for an executive must have an equitable mix of short-term and long-term incentive compensation.

a. Short-Term Incentive Compensation.

Short-term incentive compensation is usually paid to executives in the form of an annual incentive bonus.

¹⁹ Treas. Reg. § 1.409A-1(b)(1).

²⁰ For the definition of “plan,” see Treas. Reg. § 1.409A-1(c). The concept of “plan” as covered by § 409A includes many different types of compensation and benefit plans in which executives participate.

²¹ Section 409A(a)(2)(A).

²² If the agreement provides that the bonus “might” be paid within 2-1/2 months period, it will not meet the “short-term deferral” exception.

²³ See *Sutardja v. United States*, 109 Fed. Cl. 358, 2013 BL 55025 (Fed. Cl. 2013) (affirming IRS interpretation that 409A’s 20 percent surtax penalty also applies to noncompliant discounted stock options).

Larger companies typically have standard incentive compensation plans describing how annual bonuses are accrued, which should be reviewed by the executive and his or her attorney. Smaller companies or start-ups may present the employee with targets and milestones based purely on performance, while other companies (particularly financial institutions) state in their offer letters that their short-term incentive compensation is totally discretionary.

Because of current developments in the economy and the scrutiny over executive compensation, many companies (whether public or private) will have to justify their allocation of annual bonuses to their shareholders. The metrics and rationale for paying out these bonuses should be based on realistic individual achievements and performance targets. These metrics may include both the employee’s performance, the division or department performance, and the company’s overall performance throughout the fiscal year. The executive or the attorney negotiating the compensation package should insist on a clear definition of what metrics will be used in calculating the annual incentive bonus.

These metrics or the formula used to calculate them may include achievement of specific EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) targets, a certain level of sales, or other goals appurtenant to the executive’s performance of his or her responsibilities under the agreement. However, the “cause” definition in executive’s employment agreement should never include a performance trigger that could result in an employee being fired for “cause” because the employee, his department or the company did not reach the performance goals defined in the bonus formula.

While bonus guarantees have become less popular, they are not obsolete, especially in industries and areas of the economy that are currently in development and have a high probability of being lucrative in the next few years. However, it is expected that guaranteed bonuses for more than one fiscal year will not be offered (even to top executives) without clawbacks and safeguards to protect the company.

Finally, any employment agreement should state what will happen to the accrual of the bonus in the event the executive is terminated before it is paid, if the agreement expires before the end of the employer’s fiscal year, or if the bonus is in a deferred scheme and it has not vested at termination. In the event the agreement provides for any guaranteed bonus, any portion of the guarantee that remains unpaid when the employee is terminated should be paid out to the employee (sometimes in lieu of other standard severance) because of the employee’s missed opportunity cost. If no guaranteed bonus is contemplated by the agreement, the employee should at least receive a prorated portion of the annual bonus to the extent the employee fulfilled the detailed performance objectives described in the agreement.

b. Long-Term Incentive Compensation.

In order to retain talent, especially in a down economy, in addition to paying annual bonuses, companies are granting more long-term incentive compensation. Long-term incentive compensation is often structured as a grant of equity or another long-term plan that will vest over a specific period of time. By granting long-term incentive compensation to employees, com-

panies ensure that the employee is motivated to stay with the company and perform well, as the employee is now an investor in the company's losses or profits.

Long-term compensation may take the form of statutory or nonqualified stock options, restricted stock grants, phantom stock, performance shares, stock appreciation rights and other kinds of compensation. Aside from making sure that each grant of equity or employee entitlement to future grants is referenced and detailed in the employment agreement (as well as what happens to the grant in the event of termination), it is essential that such a grant of equity compensation complies with applicable tax rules.

The new limitations on executive compensation for some public companies as well as the increased scrutiny over executive compensation will mean that equity grants must be justifiable to shareholders. These recent developments have resulted in deferred compensation being subject to not only time vesting, but performance vesting. In this regard, the executive and the attorney should review all equity plans and ensure that the grants subject to performance vesting are based on realistic performance triggers and expectations.

Additionally, it is expected that many companies will go back to granting stock options to executives—a deferred compensation practice that has become less popular over the last few years, especially in public companies. The renewed interest in this type of deferred compensation is fueled by reports of executives having been paid large amounts while their companies' performance deteriorated. Rewarding executives with stock options will motivate employees to participate in the company's success and will also result in their sharing in the company's failures, as the options are worthless if the share price is below the grant price of the options.

In negotiating grants of long-term compensation, it makes sense to match the term of employment to the vesting of equity grants to ensure that the equity has a chance to vest during the employment term. Every equity plan should also contain specific information about the termination and forfeiture of the equity and a waiver and acknowledgment section in which the employee confirms his or her knowledge and understanding of the terms.

c. Clawback Provisions.

With the developments in the regulation of financial institutions and executive compensation described above, employers are frequently inserting clawback provisions into employment agreements and other executive compensation plans. Clawbacks are contractual provisions that require an employee to repay compensation following a specific event or other trigger. These provisions are usually triggered upon an employee's termination of employment, in the event of an employee's misconduct, or upon an employee's departure and subsequent work for a competitor. Although contractual clawbacks were often inserted into executive agreements to bolster restrictive covenant effectiveness and deter excessive risk-taking and other misconduct, employers have begun to use such provisions for other, broader purposes. For example, in early 2013 several banks began to insert clawback provisions into their 2012 bonus awards that allow them to recover cash bonus payments if the employee resigns within two or three years following payment. Since then, broad claw-

back provisions attached to yearend bonuses and other compensation agreements have become popular throughout the financial services industry and in many public companies.

The increased use of contractual clawback provisions for purposes other than deterring fraud and unnecessary risk-taking presents some problematic and novel legal issues. For one, it remains unsettled whether the exercise of such broad clawbacks is lawful. To the extent that contractual clawbacks seek to recoup compensation already earned, paid, and taxed, they may violate state and federal wage and hour laws that generally prohibit recollection of already-earned wages. Additionally, such provisions are at odds with Financial Industry Regulatory Authority arbitration decisions which, while they are not considered to be precedential, have held that bonuses are part of an employee's overall earned compensation, and thus are not purely discretionary. Ultimately, employers seeking to include such provisions for reasons other than to discourage misconduct are taking litigation risks.

In addition to using clawbacks on a contractual basis, certain federal regulations mandate or specifically allow clawbacks of executive compensation under certain circumstances. The Sarbanes-Oxley Act of 2002 requires recoupment of certain bonuses and other incentive compensation previously paid to a chief executive officer and a chief financial officer of a public company if it is determined that their activities significantly contributed to a financial statement restatement, which resulted in a determination that the executives had received unearned incentive compensation as a direct result of their own misconduct. The enforcement of the clawback provision of Sarbanes-Oxley lies with the SEC and does not provide private plaintiffs standing to bring a claim against the CEO or the CFO.

Under the Dodd-Frank Act, each U.S. public company will have to implement a clawback policy.²⁴ The act requires a company to recover from any current or former executive officer (following an accounting restatement due to material noncompliance with any financial reporting requirements), any incentive compensation (including equity grants) paid during the three-year period preceding the date that the company was required to prepare the accounting restatement that was based on the erroneous data. The clawback would be calculated as the excess amount paid on the basis of the restated results. Under the Dodd-Frank Act, there is no need to show any executive wrongdoing in order to recoup the compensation. The SEC has still not issued final rules regarding the act's regulatory clawback policy requirement, and thus most companies have delayed implementing this clawback policy and are only enforcing the clawback policy currently required under Sarbanes-Oxley.

Aside from the regulatory clawbacks that protect shareholders and U.S. taxpayers, most clawback provisions create a contractual obligation to pay back incentive compensation or a sign-on bonus upon an employee's termination or departure and should be carefully negotiated and drafted. In an employment agreement, the circumstances that would allow for any clawback on an annual bonus or a sign-on bonus should, if possible, be limited to termination with cause or voluntary resignation without good reason. Further, any clawback trig-

²⁴ See Exchange Act Section 10D, 15 U.S.C. § 78j-4.

ger should be limited in time and scope. Although clawback provisions have become an increasingly popular addition to executive compensation agreements, there is little evidence that employers have begun to regularly exercise them. Nonetheless, attorneys negotiating executive compensation packages should pay particular attention to such provisions because of the potentially far-reaching consequences they impose.

In regard to executive agreements or other compensation plans that contain a contractual obligation to pay back incentive compensation, the manner and timing of the payment should be carefully planned considering Section 409A consequences, standard income tax consequences, and any possible violations of wage laws that may be triggered by the clawback.

3. Negotiation Checklist

Given the changes in laws governing executive compensation and its structure discussed above, it is important to keep in mind the following goals when advising executives in a negotiation of their employment agreements:

a. Short-Term Incentives.

- For the executive employee, the employment agreement (the “Agreement”) should have a clear definition of what metrics will be used in calculating the annual incentive bonus. While the employer may want to keep it flexible as not to establish a vested right each year, there will need to be a reasonable standard of achievement that works for both parties.

- The Agreement should state what will happen to the accrual of the bonus in the event the executive’s employment ends (including what happens in the event of death or disability) before the bonus is paid.

b. Long Term Incentive.

- The Agreement should include a reference to every grant the executive will receive as well as the specific equity or deferred compensation plan that will govern the grant.

- All grants and plan documents should comply with applicable tax law and the attorney should retain assistance of tax counsel, if necessary.

- The Agreement should state what happens to vested and unvested grants upon termination of employment (including what happens in the event of death or disability);

- The Agreement should make it clear that it is the superseding and controlling document if another plan or document controls the grant of equity or deferred compensation.

- If there is a term of employment, it should match or surpass the vesting period of the equity grants so that the executive has the opportunity to earn the equity.

c. Clawbacks.

- Any nonregulatory clawback condition should not apply to vested and paid incentive compensation.

- While clawbacks on vested equity and deferred compensation have become typical in plan documents, they should comply with applicable regulations and, in the event they are nonregulatory, be limited in time and scope and only apply in the event of misconduct that is significantly detrimental to the employer and its business.

- Any clawback trigger in the Agreement and/or plan document should comply with applicable tax law.

Conclusion

In the wake of the 2008 financial crisis, legislators took steps to rein in executive pay that many considered excessive. In anticipation of regulations to implement the resulting legislation, many employers have modified their equity, deferral and bonus plans to focus more on performance-based compensation. Meanwhile, regulatory agencies have been slow to implement much of the new legislation, and employers, executives and the attorneys that represent them have been negotiating in the shadow of uncertainty. Additionally, in the years since the crisis, levels of executive compensation have begun to rise and public scrutiny has lessened.

In the years to come, attorneys who represent executives and their employers will need to be aware of compensation trends and changes in the regulatory landscape that will continue to affect compensation negotiations. Meanwhile, regulatory agencies face the challenge of implementing the new legislation in a way that reflects current compensation issues.