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EXECUTIVE COMPENSATION RESTRICTIONS FOR COMPANIES RECEIVING LOANS OR PAYROLL ASSISTANCE UNDER THE CARES ACT

The Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) was enacted March 27, 2020, and contains a massive set of laws intended to deal with the Coronavirus pandemic, including potential relief in the form of loans/loan guarantees to some employers and potential payroll assistance to the aviation industry. Recipients of the relief must agree to certain significant executive compensation limitations during a “Restricted Period,” as described below. The restrictions during this period generally provide that:

- Compensation during any 12 months during the Restricted Period cannot exceed 2019 compensation (with a further limit for employees earning more than \$3 million), and
- Severance pay during the Restricted Period is capped at twice 2019 compensation.

The legislation contains several ambiguities that require clarification, of which the definition of “compensation” may be the most pressing issue.

Background

In response to the Coronavirus pandemic, the [CARES Act](#) was signed into law on March 27, 2020. It is a \$2.2 trillion rescue package that contains a massive set of measures designed to fight the pandemic and provide relief to affected companies and workers.

Two of the most important market support provisions are sections 4003 and 4112. Section 4003 authorizes loans, loan guarantees, and other investments (“Loans”) in support of eligible businesses in an amount up to \$500 billion. Section 4112 authorizes payroll support (“Payroll Support”) to aviation workers in an amount up to \$32 billion. Multiple restrictions apply to companies that receive Loans or Payroll Support and some are very stringent.¹ This Alert focuses solely on the executive compensation restrictions, which are found in sections 4004 (pertaining to Loans) and 4116 (pertaining to Payroll Support) of the CARES Act.

¹ For example, there are share buyback and dividend restrictions on companies that receive Loans and Payroll Support.

It should be noted that there is no exception for executive compensation contracts in place. Therefore, a company considering assistance under the CARES Act will need to find a way to restructure existing executive compensation contracts and agreements if they are noncompliant with the compensation and severance limits described below.

The “Restricted Period”

Under section 4004, the Restricted Period runs from the date of the Loan until one year after the Loan is no longer outstanding. For example, a Loan provided on May 1, 2020 that is repaid on April 30, 2021 equates to a Restricted Period from May 1, 2020 through April 30, 2022. The Restricted Period is defined differently for a company that takes Payroll Support. For companies taking Payroll Support, the Restricted Period under section 4116 runs from March 24, 2020 through March 24, 2022.

An obvious question is what happens if a company takes both a Loan and receives Payroll Support. Since the substantive restrictions appear the same under both section 4004 and section 4116, it would appear that the longer period would govern.

Employees Subject to the Compensation Limitation

Officers and employees whose total compensation exceeded \$425,000² in calendar year 2019 are covered by the “compensation limitation.” The only exception is for employees whose compensation is determined by a collective bargaining agreement entered into prior to March 1, 2020.³

The compensation limitation may be simply stated—a covered employee cannot “receive” compensation during any 12 consecutive months in the Restricted Period that exceeds his or her compensation “received” in calendar year 2019. With respect to any officer or employee whose total compensation exceeded \$3 million in calendar year 2019, the limit is the sum of \$3 million, plus 50% of 2019 compensation over \$3 million. For example, an executive with 2019 compensation of \$6 million is treated as having \$4.5 million of compensation in 2019 for purposes of the compensation limitation.

A consequence of this definition is that it leaves no room for promotional considerations. A covered employee can be promoted into a higher responsibility job during the Restricted Period, but he or she cannot be paid more until the Restricted Period expires. For some companies, this could span multiple years.

What is “Compensation”?

The limitation on compensation leads to what will be the key issue under the statute—how is compensation measured? The statute simply says: “total compensation includes salary, bonuses, awards of stock, and other financial benefits provided by an eligible business to an officer or employee of the business.”

² One interpretive question is whether the phrase “whose total compensation exceeded \$425,000” modifies only the word “employees,” which would lead to the conclusion that all officers, regardless of how little they were paid in 2019, are subject to the compensation limitations. We assume the \$425,000 compensation threshold is intended to apply to both officers and employees, as we can think of no policy reason that would justify a blanket application of the compensation limitation to all officers without regard to pay level.

³ While the vast majority of employees subject to collective bargaining agreements earn less than \$425,000, there are exceptions, particularly in the entertainment industry, where actors, directors, and writers are covered by collective bargaining agreements.

There is an immediate need to clarify this language, which is susceptible to numerous, conflicting interpretations that could dramatically affect the limit. For example, it is unclear how to resolve the following issues:

- Executive receives a bonus in February 2020 for 2019 performance. This amount is both earned for 2019 and, in the case of a public company, would appear in the Summary Compensation Table (SCT) for 2019, but is technically “received” in 2020. It is unclear in which year to count this bonus.
- Executive is granted restricted stock units (RSUs) in 2020, cliff vesting in 2023. The award appears in the SCT for 2020, but becomes taxable income in 2023. It is unclear whether the RSUs are received in the reporting year or taxable year or under some different method (for example ratably received over the vesting period).
- Executive is granted a cash retention award in 2020, payable in 2023 if he or she remains employed. While the award was granted in 2020, it appears in the SCT for 2023 and becomes taxable income in 2023. It is unclear when the retention award will be considered received.
- Executive worked for only a portion of 2019 (e.g., he or she is a mid-year hire or on an unpaid leave of absence). If interpreted literally, the statute implies that an employee who worked only a portion of 2019 cannot receive compensation during any 12 months during the Restricted Period exceeding the partial year’s compensation.
- The statute specifically references compensation received in calendar year 2019. This raises questions for companies that pay bonuses and grant equity awards on a non-calendar fiscal year basis.

In deciding how to administer the statute, we hope that the regulators consider the circumstances behind the Loan and Payroll Support programs. Generally speaking, companies in need of assistance are those whose businesses were most adversely affected by the pandemic, and many of these provide essential goods and services. Companies who receive Loans and Payroll Support should not be put at risk of losing key talent to companies or industries not in need of Federal support during this critical time.

For example, suppose a Loan recipient fully repays the Loan and returns to business as usual. Further assume that it issued cash retention awards to executives during the Restricted Period in an amount designed to compensate them for the compensation foregone during the Restricted Period and these awards were conditioned on service past the end of the Restricted Period. It is difficult to see what policy concerns are thwarted by treating the payment of such awards as occurring after the Restricted Period. Presumably, the Congressionally mandated decreases in compensation during the Restricted Period do not reflect any judgment regarding the inappropriateness of the compensation, but some combination of a desire to make more funds available to repay the loan and the view that some type of compensation reduction during the Restricted Period was appropriate on the theory that higher-paid employees should share some of the economic pain incurred by lower-paid employees and the company’s shareholders.

The Severance Limit

A covered employee cannot receive “severance pay or other benefits upon termination of employment” during the Restricted Period that exceeds two times 2019 compensation. This language raises additional interpretative issues.

Literally read, this is not just a cash severance limit and could be applicable to other benefits payable in connection with any employment termination during the Restricted Period. Suppose an executive is fully vested in his or her deferred compensation, which is scheduled to be paid upon termination of employment. It is unclear if such vested amount must be counted against the severance limit. The same is true of unvested equity awards granted prior to the Restricted Period that provide for accelerated vesting upon retirement. If accelerated vesting upon retirement is considered a “benefit upon termination of employment,” it might foster the odd situation in which a retirement eligible executive must keep working during the Restricted Period because normal vesting would not trigger the severance limit, but accelerated vesting would.

We hope the regulators define severance pay to only include benefits to which an executive does not already have an unconditional right prior to termination, so that, for example, fully vested deferred compensation is excluded. Similarly, the severance definition should also exclude retirement acceleration of long-term incentive awards with respect to those employees who are “retirement eligible” under the employer’s requirements, at least in cases where the employee has the ability to treat his or her voluntary termination of employment as a retirement.

Next Steps

While much will depend on regulatory guidance, there is one clear implication for employers that may be considering taking advantage of the Loan and Pay Support provisions in the CARES Act. If they are entering into contracts with employees, it is critical to add a provision allowing the compensation provisions to be modified to the extent necessary to receive Federal assistance.

While we are still wrestling with the ideal form of such language and variations may be needed to address company-specific circumstances, our preliminary view is that the language should be broad and not overly specific insofar as the exact application of the CARES Act is still very much unknown.

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