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2020 Hot Topics in Executive Compensation

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Hot Topics

- Impact of COVID-19 on executive compensation for public companies
- Impact of COVID-19 on executive compensation for private companies
- Employee expense reimbursement issues with working from home
- Update on executive compensation cases
- Shareholder-related issues
  - ISS COVID update
  - ISS survey
  - ESG/Me Too/Purpose of a corporation
- Regulatory updates
  - Equity awards FICA timing
  - Proposed regulations Section 162(m)
  - Proposed regulations Section 4960
- Issues with executives returning to the office
- Odd and ends
- Restrictive covenants

Executive Compensation

- Public company and private company executive compensation
  - Both types of companies are trying to "pay for performance" and align executives' interests with shareholder interests
  - Shareholder interests are very different:
    - Public company shareholders are generally diverse and have a range of interests (although largest investors are typically institutional investors) and a range of ownership timelines (no horizon on investment)
      - Annual equity grants with philosophy that can change year-to-year; easier to replace executives
      - Equity plan must be reloaded every few years; institutional shareholders track burn rate
    - Private companies with PE ownership have specific investment return timetable
      - One-time grants at time of investment of PE firm; harder to reward executives who leave midstream or who join company midstream

Executive Compensation

- Private company (PE owned) typical executive compensation package
  - Base salary
  - Annual bonus
  - One-time profits interest equity grant
  - One-time capital interest, but usually only if co-investment
- Public company typical executive compensation
  - Base salary
  - Annual bonus (formulaic for disclosure purposes and not discretionary)
  - Annual equity grants
    - RSUs/PSUs
    - Options

Impact of COVID on Executive Compensation

- Public company reactions to COVID pandemic (for companies adversely impacted)
  - Voluntary/involuntary reduction in cash compensation
  - Adjustments to annual cash compensation performance goals
    - Changes disclosure for proxy
    - ISS model on trade-off between target and adjusted goals
    - Need to be able to explain to shareholders in proxy
  - Few companies making changes to long-term equity incentive goals so far
    - Annual grants so many companies may view it as ok if one or two years of grants do not pay out
    - Many companies use "relative" performance goals, so may not need adjustment (for example, relative TSR among peer group)
    - Limited stock option repricings (requires shareholder approval, which is not cheap or easy)

Impact of COVID on Executive Compensation

- Private company reactions to COVID pandemic (for companies adversely impacted)
  - A few companies are “repricing” profits interests or adjusting waterfall criteria
  - Consider effect of missed EBITDA vesting targets
  - Consider whether IRR performance goals need to be adjusted given longer horizon for companies impacted (compare with MOIC performance goals that may not need adjustment)

Employee Expense Reimbursement Laws

- Fair Labor Standards Act (FLSA)
  - No requirement under the FSLA that employers reimburse employees for business expenses but employees cannot be required to absorb business-related expenses if doing so would cause their wages to fall below the minimum federal wage and overtime requirements
  - Most states do have a statute requiring employers to reimburse employees for some expenses needed to perform the employees' jobs
  - Few employers listening here are in danger of paying below the minimum wage
  - If a potential issue, consider what potential expenses remote workers may have and whether an expense reimbursement policy for remote workers is advisable
    - Defines expected expenses (and therefore, can define excluded expenses by implication)
      - Should be consistent with expected job duties
  - For employers who will be saving dollars on transportation and parking reimbursements, consider an expense reimbursement program

Employee Expense Reimbursement Laws

- California Labor Code §2802 (the 1,800 Lb. Gorilla, emphasis added):

  (a) An employer shall indemnify his or her employee for all **necessary** expenditures or losses incurred by the employee in direct consequence of the discharge of his or her duties, or of his or her obedience to the directions of the employer, even though unlawful, unless the employee, at the time of obeying the directions, believed them to be unlawful.

  (b) All awards made by a court or by the Division of Labor Standards Enforcement for reimbursement of necessary expenditures under this section shall carry interest at the same rate as judgments in civil actions. Interest shall accrue from the date on which the employee incurred the necessary expenditure or loss.

  (c) For purposes of this section, the term "necessary expenditures or losses" shall include all reasonable costs, including, but not limited to, attorney's fees incurred by the employee enforcing the rights granted by this section.

  (d) In addition to recovery of penalties under this section in a court action or proceedings pursuant to Section 98, the commissioner may issue a citation against an employer or other person acting on behalf of the employer who violates reimbursement obligations for an amount determined to be due to an employee under this section. The procedures for issuing, contesting, and enforcing judgments for citations or civil penalties issued by the commissioner shall be the same as those set forth in Section 1197.1. Amounts recovered pursuant to this section shall be paid to the affected employee.

  (Amended by Stats. 2015, Ch. 783, Sec. 4. (AB 970) Effective January 1, 2016.)

Employee Expense Reimbursement Laws

- California Labor Code §2802 (continued):
  - Expansively interpreted
  - Would potentially apply comprehensively to materials and services required for a remote worker to do his or her job
    - Wifi access
    - Computer
    - Printer
    - Mobile phone
    - Paper
    - Office supplies (paper, pens, pencils, post-its, etc.)
- Many other states moving in similar directions
- Also consider benefits of uniform policies across US re employee morale and administration

Employee Expense Reimbursement Laws

- California Labor Code §2802 (continued):
  - Three-year claims period
  - Private Attorney Generals Act Claims/Penalties
  - Statutory interest of 10%
  - Payment of attorney's fees
  - Individual and class litigation

Employee Expense Reimbursement Laws

- Illinois 820 ILCS 115/9.5L (emphasis added below)

(a) An employer shall reimburse an employee for all necessary expenditures or losses incurred by the employee within the employee's scope of employment and directly related to services performed for the employer. ***As used in this Section, "necessary expenditures" means all reasonable expenditures or losses required of the employee in the discharge of employment duties and that inure to the primary benefit of the employer***. An employer is not responsible for losses due to an employee's own negligence, losses due to normal wear, or losses due to theft unless the theft was a result of the employer's negligence. An employee shall submit any necessary expenditure with appropriate supporting documentation within 30 calendar days after incurring the expense, except that an employer may provide additional time for submitting requests for reimbursement in a written expense reimbursement policy. Where supporting documentation is nonexistent, missing, or lost, the employee shall submit a signed statement regarding any such receipts.

(b) An employee ***is not entitled to reimbursement under this Section if*** (i) the employer has an established written expense reimbursement policy and (ii) the employee failed to comply with the written expense reimbursement policy. An employer is not liable under this Section unless the employer authorized or required the employee to incur the necessary expenditure or the employer failed to comply with its own written expense reimbursement policy. If the written expense reimbursement policy of an employer establishes specifications or guidelines for necessary expenditures, the employer is not liable under this Section for the portion of the expenditure amount that exceeds the specifications or guidelines of the policy so long as the employer does not institute a policy that provides for no reimbursement or *de minimis* reimbursement.

(c) (c) To ensure consistency with federal law, any rules adopted by the Department and interpretation of this Section shall be consistent and not in conflict with federal regulations and guidelines regarding employer requirements for reimbursement of employee expenses.

Employee Expense Reimbursement Laws

- **District of Columbia.** The District of Columbia requires an employer to reimburse its employees for the cost of tools required for the employee to perform the employer's business. D.C. Mun. Reg. title 7, § 910.1.
- **Minnesota.** Upon an employee's termination of employment, an employer must reimburse an employee for previously deducted amounts from an employee's wages for certain items, including consumable supplies required in employment and travel expenses other than commuting expenses. § 177.24 MN Statutes.
- **Iowa.** Expenses by the employee *which are authorized by the employer and incurred by the employee* shall either be reimbursed in advance of expenditure or be reimbursed not later than thirty days after the employee's submission of an expense claim. If the employer refuses to pay all or part of each claim, the employer shall submit to the employee a written justification of such refusal within the same time period in which expense claims are paid under this subsection. Iowa's Code § 91A.3(6).

Employee Expense Reimbursement Laws

- **Montana.**
  - **39-2-701. Indemnification of employee.** (1) An employer shall indemnify an employee, except as prescribed in subsection (2), for all that the employee necessarily expends or loses in direct consequence of the discharge of duties as an employee or of the employee's obedience to the directions of the employer, even though unlawful, unless the employee at the time of obeying the directions believed them to be unlawful

    2) An employer is not bound to indemnify an employee for losses suffered by the employee in consequence of the ordinary risks of the business in which the employee is employed

    3) An employer shall in all cases indemnify an employee for losses caused by the employer's want of ordinary care

  - Note: *Language is similar to California's*
  - Good News: Not that many people/employees in Montana (2020 Estimate: 1,074,532)

Employee Expense Reimbursement Laws

- **New Hampshire.** New Hampshire's statute requires employers to reimburse employees, within 30 days of an employee submitting receipts, for expenses incurred "in connection with his or her employment *and at the request of the employe*r, except those expenses normally borne by the employee as a precondition of employment." N.H. Rev. Stat. Ann. § 275:57

- **Pennsylvania.** If a Pennsylvania employer adopts an expense reimbursement policy, Pennsylvania law treats an incurred expense as a "fringe benefit" for which an employer must reimburse an employee "within 10 days after such payments are required to be made directly to the employee, or within 60 days of the date when proper claim was filed by the employee in situations where no required time for payment is specified." 43 Pa. Stat. § 260.3

  - Employers should include a 60-day payment period in an expense reimbursement policy for Pennsylvania employees

- **New York.** The "benefits and wage supplements" provision of New York's wage laws does not apply to any person in a bona fide executive, administrative, or professional capacity whose earnings are in excess of $900 a week. N.Y. Labor Law § 190(1).

Employee Expense Reimbursement Laws

- Be proactive
  - Employees are paying attention and making claims
  - Review expense reimbursement policies like vacation policies – policies need to comply with all state laws where employees work; one size does not fit all
  - Determine what equipment and services employees actually need to effectively do their jobs
  - Explain what is (and is not) necessary for an employee to do his or her job
  - Settle disputes promptly
- What happens when employees can/must return to the office?
  - Whose choice to work remotely is it? Is working remotely (i) pursuant to a government-ordered mandate, (ii) the employer's mandate, or (iii) for the employee's convenience?
  - Distinguish between a *requirement* to work remotely and the *convenience* to work remotely in an expense reimbursement policy
- In M&A during and post-COVID:
  - Purchasers: Consider potential liabilities related to target's failure to reimburse employees where required; add rep and warranty
  - For sellers: Can you make a rep that all reimbursements have been made?

Employee State Tax Withholding

- Employers need to consider whether employee's working from home or remotely impacts any state tax issues
- Need to consider and review with accountants whether any adjustments need to be made for any executives or groups of employees who are working in different states during pandemic

Recent Cases
Section 409A

- Violations of Section 409A trigger adverse tax consequences for the service provider, including immediate taxation of vested benefits under the plan (and all similar plans) and a 20% additional income tax and penalty interest
- Until recently, employers were focused on reporting and withholding obligations, but litigation from participants may become an increased risk
- Plan participants sue over Section 409A failures:
  - *Rabbi Stanley Kroll v. Cozen O'Connor* (Northern District of Illinois)
    - Section 409A failure as aiding and abetting a fraudulent reduction of retirement benefits
  - *Wilson v. Safelite Group, Inc.* (Sixth Circuit)
    - Distinguishing between ERISA vs. Non-ERISA NQDC Plans; Non-ERISA plans may leave open contract claims under Section 409A

Recent Cases
Section 409A

- *Allegis Group, Inc. v. Jordan* (Fourth Circuit)
  - Post-employment incentive payments – conditions precedent may be allowed where restrictive covenants would otherwise be unenforceable
- *City of Fort Myers General Employees' Pension Fund v. Haley* (Delaware Supreme Court)
  - CEO/Director was found to have breached his fiduciary duty in merger negotiations
- *SEC Cease-and-Desist Enforcement Action against Argo Group International Holdings, Ltd.*
  - *Hot topic for SEC enforcement - failure to disclose perquisite payments in proxy; SEC imposed a $900,000 civil penalty*

Shareholder Concerns
ISS COVID-Related Guidance

- ISS issued COVID-19-related guidance on April 8, 2020
- Available at: https://www.issgovernance.com/file/policy/active/americas/ISS-Policy-Guidance-for-Impacts-of-the-Coronavirus-Pandemic.pdf
- ISS recommends contemporaneous disclosure of any changes
- ISS does not favor changes to long-term performance goals
- Case by case review as part of proxy voting at next annual meeting

Shareholder Concerns
ISS COVID-Related Guidance

- ISS Corporate Solutions (Consulting Side of ISS) published 4 case studies of adjustments to annual goals
  - Case Study #1 Mid-year adjustment of target goals with corresponding reduction in payout amounts by 25%
  - Case Study #2 Replace full-year goals with half-year goals and reduction in payout amounts by 50%
  - Case Study #3 Replace absolute performance goals with relative performance against peer group (with cap for negative absolute performance) and no reduction in payout amounts.
  - Case Study #4 Replace absolute performance goals with relative TSR against peer group (with cap for negative absolute performance) and no reduction in payout amounts

Shareholder Concerns
ISS COVID-Related Guidance

- ISS Survey (available at: https://www.issgovernance.com/wp-content/uploads/publications/2020-iss-policy-survey-results-report-1.pdf)
- When asked about the respondent's viewpoint regarding executive compensation in the wake of the pandemic, a significant majority of investor respondents (70%) indicated that the pandemic's impact on the economy, employees, customers, and communities and the role of government-sponsored loans and other benefits must be considered by boards and incorporated thoughtfully into compensation decisions to adjust pay and performance expectations and should be clearly disclosed to shareholders
- Among non-investors, a majority (53%) indicated that the pandemic is different from previous market downturns and many boards and compensation committees will need flexibility to make decisions regarding reasonable adjustments to performance expectations and related changes to executive compensation
- Regarding short-term/annual incentive programs and the respondents' views on what is a reasonable company response under most circumstances, slightly over one-half of both investors (51%) and non-investors (54%) indicated that both (1) making mid-year changes to annual incentive metrics, performance targets and/or measurement periods to reflect the changed economic realities; and (2) suspending the annual incentive program and instead making one-time awards based on committee discretion could be reasonable, depending on circumstances and the justification provided

Other Current Issues for Compensation Committees

- Consider role of compensation committee in monitoring:
  - Environment, social and governance issues
  - Social and political issues
  - Gender pay disparity
  - Diversity initiatives
- Review and consider revisions to definition of "Cause" in executive compensation-related agreements
- Consider updates to clawback policies for bad behaviors other than financial restatements
- Updated discussions on purpose of a Corporation

Equity Awards FICA Guidance

- The IRS released two informal updates to guidance on income inclusion timing, and withholding and deposit rules, for stock options and for stock-settled stock appreciation rights ("SARS") and restricted stock units ("RSUs")
  - IRS issued Generic Legal Advice Memorandum 2020-004 (the "GLAM") on May 22, 2020, which outlines the views of the IRS Office of Chief Counsel with respect to the timing of income inclusion and the application of Federal Insurance Contribution Act ("FICA") and Federal income tax ("FIT") withholding and deposit obligations for three types of stock-settled equity awards
  - Second, the IRS updated Section 20.1.4.26.2 of the Internal Review Manual ("IRM Update") on May 26, 2020, to expand the categories of equity awards eligible for certain administrative relief from the penalties of the Next-Day Deposit Rule, while slightly tightening the conditions for such relief
- Blog Post at: https://www.usbenefits.law/2020/08/irs-updates-guidance-on-timing-of-wage-and-fica-withholding-for-stock-options-and-rsus/
- Options: The IRS reaffirms its long held position that the fair market value (minus the exercise price) of shares of stock transferred to an employee pursuant to a stock option are includible in income under Code Section 83 on the date that the employee exercises the option. In addition, based on inferences drawn from prior revenue rulings, the GLAM takes the position that this amount is treated as wages paid to the employee on the exercise date, triggering the employer's FICA and FIT wage withholding obligations on that date, even though the shares in settlement of such stock option may not be deposited in the employee's brokerage account for two days.

Equity Awards FICA Guidance

- SARs: Under the facts of the GLAM, upon exercise of an SAR, an employee is entitled to the number of shares of employer stock equal to the difference between the fair market value of a share of such stock on the date of exercise over its fair market value on the date of grant, divided by the fair market value of a share of such stock on the date of exercise. The fair market value of the shares received on the date of exercise is includible in income by the employee and constitutes wages paid subject FICA and FIT. Similar to the options, the date of exercise is the liability incurred date, i.e., the date that triggers the requirement for the employer to remit FICA and FIT with respect to such exercise (even though the shares in settlement of such SAR may not be deposited in the employee's brokerage account for 2 days).
- RSUs: The employee's income inclusion is triggered on the date that the shares are transferred (within the meaning of Section 83 of the Code). The GLAM takes the position that the transfer of shares for purposes of Section 83 occurs when the employer initiates the transfer of shares, even though it may take up to two days for the shares to be deposited in the employee's brokerage account. The fair market value of the shares on such date constitutes wages subject to FICA and FIT withholding, and the date that the employer initiates the transfer triggers the requirements for the employer to remit FICA and FIT with respect to such transfer (even though shares in settlement of such RSUs may not be deposited in the employee's brokerage account for 2 days).

Equity Awards FICA Guidance

- Under the new guidance in the IRM Update, in the case of stock options and SARs, the settlement date rather than the exercise date of the award will be treated as the liability incurred date for purposes of calculating FTD penalties under the One-Day rule, provided that the settlement date is within two days of the exercise date
- Similarly, in the case of RSUs, the settlement date rather than the transfer initiation date will be treated as the liability incurred date for penalty purposes, again, provided that the settlement date is within two days of the transfer initiation date

Section 162(m)
Tax Reform Changes

- Tax Reform Act made three significant changes to Section 162(m)
  - Broadened definition of publicly traded company to include companies that are required to file reports under Section 15(d) of the Securities Exchange Act of 1934 (public debt)
  - Changed definition of "Covered Employees"
  - Performance-Based Compensation exception eliminated!
- Changes to Section 162(m) do not apply to remuneration that is provided pursuant to a written binding contract that was in effect on November 2, 2017, and that was not modified in any material respect on or after that date ("Grandfather Rule")

Section 162(m)
Tax Reform Changes

- On August 21, 2018, the IRS issued Notice 2018-68, which provides guidance on certain changes made to Section 162(m) by the Tax Cuts and Jobs Act (the "Act")
- Proposed regulations were issued on December 20, 2019, and are available at: https://www.govinfo.gov/content/pkg/FR-2019-12-20/pdf/2019-26116.pdf
- Proposed Regulations continue to provide a narrow interpretation of the grandfather rule

Section 162(m)
What to Do Now? Proactive Considerations

- Take steps to track any employees who could be considered a Covered Employee in future years (try to avoid accidental "one-year" NEO, who then becomes permanent Covered Employee):
  - Consider who is an "officer"
  - Track officers who have compensation close to the top three
- Consider requiring deferrals of compensation above a certain amount each year and requiring such amounts to be paid in installments in future years

Section 162(m)
What to Do Now? Proactive Considerations

- Make use of equity inducement grants
  - Consider making equity grants to any newly hired executive officers as inducement grants instead of grants from a shareholder-approved plan
  - Previously of limited value (performance-based compensation exception required a grant from a shareholder-approved plan)
- Reconsider more subjective performance goals
  - Consider whether cash and equity grants that have performance goals should have some subjective adjustment component added (previously an issue for performance-based compensation)
  - Be careful of too much discretion, causing disclosure to shift from non-equity incentive compensation to bonus in the summary compensation table

Section 4960
Potential Application to For-Profit Employers

- Section 4960 imposes an excise tax of 21% on compensation paid to a Covered Employee (as defined for 4960) of a tax-exempt organization in excess of $1 million or if an excess parachute payment
- Section 4960 can apply to compensation paid to a Covered Employee by any "related person"
- A "related person" can include a for-profit business if such business is under common control
  - Foundations that are tax exempt and that are set up and controlled by for-profit corporations can be a related person to such foundation
- Covered Employees could include executives of the corporation, which could trigger the excise tax on compensation paid by the corporation
- Any public or private business that has set up a related foundation or other not-for-profit organization needs to review and consider this issue

Section 4960
Potential Application to For-Profit Employers

- Proposed Regulations issued on June 5, 2020, and available at: https://s3.amazonaws.com/public-inspection.federalregister.gov/2020-11859.pdf
- Two helpful exceptions for related person issue:
  - Under the limited hour exemption, a shared employee of both a for-profit and related tax-exempt organization will be disregarded for the purposes of determining the five highest-compensated employees if the shared employee does not spend more than 10% of his or her time, or more than 100 hours annually, providing services to the tax-exempt
  - Under the nonexempt funds exemption, a shared employee is similarly disregarded if the employee is not paid by the tax-exempt organization itself, where the employee's services are primarily provided to the nonexempt organization

Managing and Mandating Returns to the Office

- State mandates to shelter-in-place, employers closing their offices, COVID outbreaks in the workplace, and flexibility to work remotely have all upended pre-COVID practices on working remotely
  - How will employers be managing and mandating returns to the office?
  - What employers should be doing to prepare?
  - What to do about employees who do not want to come back to the office – can the employer require them to work in the office?
  - Policies and procedures
  - Accommodations

Managing and Mandating Returns to the Office

- In principle, the employer sets terms and conditions of employment and can require employees to work in the office or remotely
- But employee morale and employee retention are also important considerations, especially with executives
- Family considerations are important for many executives and employees
- Visa and travel considerations for executives and employees who do not have US citizenship
- And, employers must avoid discriminatory treatment and comply with protections for employees with disabilities
- Federal and state laws provide employees with disabilities certain protections – Americans with Disabilities Act and similar state laws – including reasonable accommodations

Managing and Mandating Returns to the Office

- What about employees who state they cannot come to the office, because:
  - Employee has a serious health condition that puts the employee at increased personal health risk if the employee becomes infected with COVID – e.g. diabetes, asthma, autoimmune diseases, heart disease
  - Employee lives with a person in the household who is at increased personal health risk if the employee becomes infected with COVID
- Application of ADA may be different in COVID – see EEOC guidelines, as they are updated; keep track of law firm legal updates
  - For example, if diabetes is under control with medication, an employee may not be entitled to an accommodation in normal times – but may be entitled to a reasonable accommodation, including remote work, if COVID is a risk in the workplace or region
  - Interactive process and individualized consideration is key to showing compliance with the law
  - Pre-COVID, employers could rely on a uniform policy putting strict limit on remote work; upon return to the office from COVID, it becomes more difficult for employers to show providing remote work is not a reasonable accommodation due to undue hardship

Managing and Mandating Returns to the Office

- Generally, the ADA does not require the employer to provide a reasonable accommodation to an employee due to the disability of a family member, but tricky ADA questions can arise
- Other considerations – OSHA, state OSHA, local public health authority guidelines, rules, pressure, risk of liability where the employee or household members suffer permanent harm or death from COVID

Managing and Mandating Returns to the Office

- What about employees who state they cannot come to the office, because:
  - The employee must be at home with children who cannot go to school or day care
  - The employee has traveled to a place requiring quarantine
  - The employee has been in close contact with another person who has been diagnosed with COVID
  - The employee is now living in a remote location
- Employers must consider legal requirements:
  - Families First Coronavirus Act (FFCRA)
  - Expanded FMLA coverage
  - State and local laws providing sick leave and other coronavirus leave

Managing and Mandating Returns to the Office

- Where there is no legal requirement, many companies are taking a practical approach:
  - Expanding leave opportunities (paid or unpaid) temporarily during COVID
  - Creating new policies to support employees temporarily during COVID
  - Allowing exceptions to policies with due regard for consistency and non-discrimination
  - Many goals:
    - Ease administration
    - Keep talent
    - Maintain or enhance perception of safety in the workplace and actual safety
    - Maintain employee morale

Managing and Mandating Returns to the Office

- **Where COVID Remains a Risk** (continued)
  - Keep good records
    - Helps in litigation
    - Helps in dealing with similar circumstances
    - Supports consistency in similar circumstances

Managing and Mandating Returns to the Office

- **Where COVID Is No Longer a Risk**
  - Pre-COVID, most employers had fairly rigid rules, with having a disability being about the only way to obtain an exception
    - If an employer required an employee to work in the office, absent the need for an accommodation for a person with a disability and assuming no other impermissible reason for the discharge and also no contractual right to work remotely), an employer could discharge an employee for failing or refusing to work in the office
  - How has COVID changed that?
    - COVID has demonstrated that people can productively work at home
    - Most employers will be more flexible
    - Some executives and other employees will be able to insist upon it
    - New policies regarding who can work remotely will emerge
      - Important to adhere to the policy and act consistently but likely to be a high degree of flexibility

Managing and Mandating Returns to the Office

- **Where COVID Is No Longer a Risk** (continued)
  - Why is consistency important?
    - Inconsistency in allowing employees to work remotely could give rise to claims based on discrimination against a protected class or other protected reason
  - Is an employee's fear of returning to the office where there is no actual risk of COVID a basis for claiming a disability?
    - Currently hypothetical – but generally not; an employee would have to have a documented and identifiable psychological or medical disorder in order to be legally entitled to an accommodation to work at home
  - Some things never change:
    - Employers will do their best to accommodate top performers
    - Where the talent pool is tight, executives will have heightened bargaining ability

Odds and Ends

- "Cause" definitions in employment agreements that do not include misconduct such as harassment or consensual but inappropriate relationships
  - Often can be covered by a reference in the definition of "cause" to violations of the employer's code of conduct
- Overbroad indemnity provisions in employment agreement that do not take applicable corporate law and the company's bylaws into consideration
- Lack of clawback authorizations in public company employment agreements
- A public company employment agreement that guarantees an executive a board seat
  - The company's shareholders may beg to disagree
  - Instead, a failure to nominate will constitute a breach of the agreement

Odds and Ends

- "We want to fire an executive but we don't want to pay him (or her) severance. Can you figure out a way that we don't have to pay severance?"
  - By the time such a request finds its way to us, there's often a horrible chain of emails between company executives that is discoverable in litigation
- Multi-state restrictive covenants more than a year old
- "There must be some way of preventing an executive in California from working for our arch rival"
- "We don't have to file a Form S-8 for our nonqualified deferred because we don't have a stock fund investment option"

Update on Restrictive Covenant Laws

- There has been a wave of recent state legislation restricting non-competes:
  - Massachusetts
  - Maryland
  - Illinois
  - Washington
  - Oregon
  - Idaho
  - Utah
  - Rhode Island (effective January 1, 2020, for non-exempt employees, undergraduate and graduate intern ships, minors and low-wage workers)

Update on Restrictive Covenant Laws

- In 2020, Virginia has joined other states (Illinois, Maryland, Maine and New Hampshire) that prohibit non-competition agreements for low-wage workers
  - Prohibition applies to individuals whose average weekly earnings are less than the Virginia average or an independent contractor compensated at less than Virginia's median hourly wage
  - Excludes workers whose earnings are derived wholly or predominantly from sales commissions, incentives or bonuses
  - Prohibition applies as long as employee does not initiate contact with or solicit the customer or client
  - Authorizes Virginia's labor authorities to assess a civil penalty against an employer of $10,000
  - Information on the new law must be posted in the workplace

Update on Restrictive Covenant Laws

- On January 1, 2020, a new law went into effect in **Oregon** which requires employers to provide a signed, written copy of an employee's non-compete agreement within 30 days of the employee's termination date. Failure to do so renders the non-compete agreement void and unenforceable in the state of Oregon.
- Also on January 1, 2020, **Washington** state's new restrictive covenant law went into effect. One of the toughest in the country, it is "void and unenforceable" against employees earning less than $100,000 per year ($250,000 for independent contractors), both of which will be indexed
  - Employers must disclose non-compete's terms no later than the time the employee accepts an offer of employment
  - Non-competes entered into after the commencement of employment must be supported by independent compensation
  - Statutory presumption that non-competes with a restrictive period of more than 18 months after termination are unreasonable and unenforceable (can be overcome by "clear and convincing evidence")
  - Employees terminated due to a "layoff" must receive compensation equivalent to the employee's base salary for the entire restricted period
  - Venue provisions outside of Washington unenforceable if the employee is Washington-based; choice of law provisions are void and unenforceable if employee is deprived of the benefits of the law

Update on Restrictive Covenant Laws

- Washington state (continued)
  - Employers can be liable for the greater of actual damages or a statutory penalty of $5,000 plus attorneys' fees, expenses and costs if
    - It is determined that the non-compete agreement covenant violates the new law or the non-compete is reformed or modified or is only partially enforced
    - Law is likely to deter many employers from enforcing a non-compete because the consequences of not entirely winning could be substantial

Update on Restrictive Covenant Laws

- **Massachusetts**
  - At the commencement of employment, restrictive covenant
    - Must expressly state that the employee has the right to consult with counsel prior to signing
    - Must be provided to the employee before a formal offer of employment is made or 10 days before the commencement of the employee's employment, whichever comes first
  - After employment has commenced, restrictive covenant
    - Must be supported by fair and reasonable consideration (other than continuing employment)
    - Must provide at least 10 days' notice
    - Must expressly state that the employee has the right to consult with counsel prior to signing

Update on Restrictive Covenant Laws

- **Massachusetts**
  - Restricted period cannot exceed one year from the employment termination date
    - Two years if employee has breached his or her fiduciary duty to employer or the employee has unlawfully taken the employer's property
  - Non-compete agreements must include a garden leave clause providing pay for the garden leave period of at least 50% of the employee's highest base salary over the prior two years or other mutually agreed upon consideration
    - "Other mutually agreed upon consideration" not defined
  - Does not apply to
    - Customer or employee non-solicitation agreements
    - Non-compete made in connection with the sale of a business
    - An agreement made in connection with the cessation or termination of employment if the employee is given 7 business days in which to rescind acceptance

Update on Restrictive Covenant Laws

- **Massachusetts**
  - Noncompetition agreements are unenforceable against
    - Employees terminated without cause or laid off
    - Non-exempt employees under the FLSA
    - Undergraduate or graduate students engaged in short-term employment
    - Employees under age 19

Update on Restrictive Covenant Laws

- COVID Considerations: Enforceable if Employee Terminated without Cause or Laid Off? It's state-specific.
  - **New York.** Some courts have refused to enforce a restrictive covenant if an employee has been terminated without cause
  - **Illinois.** Absent consideration beyond continuing employment, the Illinois appellate courts (the Illinois Supreme Court has yet to weigh in) have adopted a bright line requirement of two years of employment in order for a covenant not to compete to be enforceable. The amount of consideration that is sufficient for a non-compete to be enforceable is unclear.
  - **Massachusetts.** For non-competes entered into after October 1, 2018, non-compete agreements are not enforceable against employees who have been terminated without cause or laid off. MGL ch. 149 §24L(c). For non-competes entered into prior to October 1, 2018, the answer is less clear. However, noncompetition agreements made in connection with the cessation of or separation from employment are enforceable if the employee is expressly given seven business days to rescind acceptance.
  - **Pennsylvania.** The courts look at all the facts and circumstances but do uphold non-competes where an employee has been laid off
  - **Nevada.** If an employee is terminated due to a "reduction in force, reorganization or similar type of restructuring," the employer may enforce the agreement only "during the period in which the employer is paying the employee's salary, benefits or equivalent compensation, including, without limitation, severance pay." NRS § 613.195.

Update on Restrictive Covenant Laws

- **Connecticut and New Jersey.** Courts have refused to enforce a non-compete upon finding that to do so would cause undue hardship
- Distinguish between a non-compete and non-solicitation provisions
  - Recent statutes that strictly regulate non-compete agreements may not apply to non-solicitation provisions (clients, customers, employees), and courts in other jurisdictions may strike down a non-compete provision but enforce a non-solicitation provision
    - Consider the extent to which a non-solicitation provision will be sufficient to protect an employer's interests
    - In terminations without cause and layoffs, consider whether the forfeiture of severance and/or other consideration will be a sufficient deterrent from competing

Update on Restrictive Covenant Laws

- **What does the future hold?**
  - More states are likely to enact legislation regulating non-competes
  - Possible new efforts at the federal level
    - In 2019 a bill was introduced by a Democratic Senator (Chris Murphy, D-Conn.) and a Republican Senator (Todd Young, R-Ind.) to ban non-compete agreements other than in connection with the sale of a business or the dissolution of a partnership (mirroring the two exceptions to California's statute prohibiting non-competes)
    - The FTC held a workshop on January 9, 2020, examining whether there were reasons to justify a FTC rule restricting non-compete provisions in employment contracts
    - The Department of Justice held a workshop examining the effects of non-competes in the labor market and from an anti-trust perspective
      - Coordinate with deal counsel as to whether anti-trust concerns warrant restricting access to target information regarding salaries, wages and benefits

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