PARACHUTES WITH A PURPOSE

These five design elements help ensure CIC arrangements align executives with shareholder interests during transactions. By Tina Murphy and James Limmer

IN A MERGER AND ACQUISITION environment, where scrutiny is high and single change-in-control (CIC) provisions can lead to an "Against" recommendation from proxy advisors, outdated "golden parachute" arrangements can quickly become a distraction, or worse, a liability. While boards still need to retain and protect executives during transactions, today's market-leading practices reflect a disciplined approach that is reflective of external market direction and large asset management firm, and proxy advisory firm policy. The goal is to ensure that CIC protections make executives economically neutral about a potential transaction and align with shareholder expectations and governance norms. Below, we outline five ways that are now standard practice for CIC protections, while keeping effectiveness and fairness intact. [Note: All statistics are from Meridian's 2023 Study of CIC Severance Arrangements, which looks at all constituents of the S&P 500.]

1. Keep Severance Multiples in Check

Investors increasingly expect severance payments to reflect actual loss rather than a cash windfall. While cash severance of 3x base salary + bonus was once the predominant standard for CEOs, prevalence is now more evenly split between 3x (47 percent) and 2x – 2.5x (42 percent). Other NEOs typically receive 2x base + bonus. Additionally, while target bonus is still the most common way to define the bonus amount used in cash severance calculations, some designs calculate severance using base salary plus the average of the last three years' actual bonus payments. This can reflect a more accurate estimate of value lost by the executive.

2. Double-Trigger Equity is the Standard

The days of automatic ("single-trigger") equity acceleration at deal close are largely over. Most companies (90 percent-plus) now follow a "double-trigger" approach such that equity only vests if there is a CIC and a qualifying termination within a defined window (typically 12–24 months post transaction). This practice is now considered standard by proxy advisors and institutional investors, and any single-trigger benefits are routinely flagged by ISS as a problematic pay practice. Companies should consider phasing out any legacy arrangements with single-trigger vesting and redesigning equity award agreements with double-trigger provisions.

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3. Clarify "Cause" and "Good Reason" Definitions

Modernizing CIC arrangements is not just about quantum or structure—it's also about language. There are examples of legacy agreements that include vague or broad employment termination definitions of "cause" and "good reason," which can lead to disputes, unintended payouts or unfavorable governance optics. Today, approximately 70–80 percent of companies rely on standardized CIC agreements or severance plans rather than individualized employment agreements—a shift that creates a valuable opportunity to align and standardize key terms across participants. To reduce risk and strengthen governance alignment, companies should consider reviewing and updating these definitions to reflect objective, clear and market-aligned definitions.

4. Eliminate 280G Tax Gross-Ups

Few provisions are as outdated—or as inflammatory—as Internal Revenue code section 280G tax gross-ups. These provisions provide cash payments to executives to cover the full cost related to excise taxes on CIC payments. These payments are now seen as red flags by proxy advisors and investors. Accordingly, just 5 percent of companies maintain full or modified tax gross-ups. Instead, today's standard approach is "Best Net," which ensures that an executive receives the greater of (a) the full CIC payment with applicable excise taxes being paid by the executive or (b) a reduced severance amount that avoids the excise tax—whichever yields the higher after-tax benefit to the executive.

5. Be Transparent About Legacy Agreements

Boards occasionally inherit legacy CIC arrangements that may include single triggers or even excise tax gross ups. If these provisions cannot be eliminated immediately, disclose them clearly and signal the intent to phase them out. Proxy advisors are more lenient when a clear transition plan is communicated.

CIC severance arrangements remain vital to align executives with shareholders during a company sale and to retain executives throughout the process. Market-leading designs protect only when protection is needed and follow clear and consistent triggers. With the proper structure in place, companies can provide parachutes with a purpose, while retaining talent, minimizing outside scrutiny and closing deals without the headlines.

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