

Ready to Expand Your Clawback Policy? Not so Fast . . .

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For many years, companies decided to wait for the clawback requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act to be finalized before taking action. More recently, many have stopped waiting. In public company boardrooms across the United States and abroad, there is a growing trend to expand company clawback policies beyond current regulatory requirements to include additional triggers for addressing employee misconduct through the use of their clawback rights. The focus on clawbacks is in large part a result of the media attention and stakeholder engagement associated with recent high profile corporate scandals and cases that have triggered the #MeToo Movement, among others. But once a company decides to expand its clawback policy, sometimes the rush to implement policy changes comes at the expense of thoroughly evaluating the practical implications that an expanded clawback policy may have.

Before modifying their clawback policies, we advise companies to take the following steps to ensure that their clawback policies are implemented in concert with other corporate policies and arrangements and in a manner that is consistent with their intentions:

1. **Catalog all corporate policies and arrangements in which clawback provisions exist.** Clawback provisions are not only in standalone policies, but they are also often found in incentive plans, omnibus plans and employment, severance and change-in-control arrangements. When implementing a new or revised clawback policy, it is important to review all the clawback provisions already in place to make sure they are not inconsistent in their terms or application, which could otherwise negatively impact the company's ability to implement and enforce its clawback powers when it counts the most.
2. **Consider the interaction of the company's "Cause" definition with applicable clawback triggers.** Depending on the nature of each of the triggers that constitute "Cause", a company should give careful consideration as to whether the clawback policy should apply if an employee is terminated for Cause, and if so, whether the clawback policy should apply to only certain Cause triggers or all of them? This is generally a philosophical question about the proper punitive action to be taken in the event an employee's misconduct – under certain circumstances, loss of employment itself may be a sufficient level of

punitive action, while in other circumstances, it may be appropriate that the loss of employment be coupled with a clawback of past incentive compensation. When weighing these considerations, another issue to keep in mind is the corporate resources it may take for a company to try and collect monies to be clawed back under the circumstances, especially in some non-U.S. jurisdictions or when taxes have already been paid on incentive awards.

3. **Consider whether the clawback provisions should include severance already paid.** There may be unusual circumstances under which the company has paid severance to a former employee (as a result of an involuntary termination without Cause), but later it is determined that the employee's actions (while he/she was still employed) would have potentially triggered a termination with Cause and/or the application of the clawback policy if the former employee had remained employed at the company. In that event, consider the circumstances under which a company may wish to clawback severance already paid (and/or any favorable vesting treatment on equity incentives, as the case may be) as a result of the employee's actions.

4. **Consider limiting the application of clawback policies, depending on employee level and pertinent triggers.** When expanding a clawback policy, we believe it is important to consider how the clawback policy might impact each of the covered individuals, from company executives down to entry-level employees. Specifically, we believe the policy must consider the amount of potential compensation in play and the employee's total compensation. For example, clawing back \$1,000,000 from an executive who earns \$5,000,000 per year, while quite significant in magnitude, may effectively be less punitive to the executive than clawing back \$7,000 from an employee who typically earns \$35,000 per year, where the \$7,000 is more likely to be a critical portion of the employee's pay which is relied upon for basic living expenses. This illustrative example highlights the importance of determining whether clawback policies should be applied on a discretionary versus non-discretionary basis, as well as whether certain clawback triggers may be limited to executive-level employees, while other triggers may be applied more broadly. Again, consideration should be given to the corporate resources it may take to enforce the company's clawback rights, depending on the level of employee and the amount of money at stake. In addition, consideration should be given with respect to the level at which the compensation committee should get involved (e.g., situations involving officers), with senior management being responsible for other employee situations.

We applaud the trend towards clawback expansion as a sign of good governance in protecting a company's financial stability and reputation, as well as its employees. And by following the additional steps suggested above, a company can help ensure its clawback policies can be implemented as intended, while avoiding internal conflicts among corporate policies and any other unintended consequences.