WINSTON & STRAWN LLP

PODCAST

Episode 7: Reduce Your Risk of Getting Sued: Drafting Tips for Executive Employment and Compensation Agreements

JULY 29, 2019

We encourage you to subscribe via Apple iTunes or Google, or via the RSS feed here.

Audio Transcript:

Steve Flores: Welcome to another episode of Winston's Benefits Blast Podcast. I'm Steve Flores and I'm delighted to be joined today by my partner, Mike Melbinger. Mike has received numerous recognitions for his work in employee benefits and executive compensation and he is the author of the cleverly titled book *Executive Compensation* and the well-known and very widely read Executive Compensation blog.

Steve Flores: During this episode we will be talking about drafting improvements for executive employment and compensation agreements that should help reduce the risk of getting sued. So Mike, you're known for your executive compensation practice, why are you talking about getting sued or litigation?

Mike Melbinger: Well Steve, we read all of the court decisions on compensation issues, and there are a lot of them. We read the cases because quite often those decisions turn on the meaning of certain words, phrases, and provisions that we see every day in executive compensation plans and agreements. And even if the decisions come out in favor of the employer, that is where the employer wins, we feel we can still learn ways that certain common words, phrases, and provisions may be misused or misinterpreted by employees, by executives, plaintiff's lawyers, or even the courts, so we try to improve our drafting accordingly.

Mike Melbinger: Let me add here, that any lawsuit that has proceeded to a published court decision is likely to have already cost the employer dearly in both time and treasure, even if the employer eventually wins the lawsuit. We want to avoid any provisions that could possibly be misinterpreted in any way and any traps we can find in these cases.

Mike Melbinger: Today I'm going to talk about a drafting point that I have discussed previously in the Executive Compensation blog, which appears on our website and a couple other websites. The topic is the need to define compensation or earnings narrowly in plan documents and agreements, especially in non-qualified deferred

compensation plans. This definition just keeps arising in court cases over and over again so I think it's worth discussing again.

Steve Flores: Great, Mike. Can you give us some examples of that?

Mike Melbinger: I just so happen to have a few of them on the tip of my tongue right now. A recent unpublished federal district court decision out of New Jersey, *Weller vs. Lindy Pension Excess Program*, can teach us a couple of important lessons, one of which we'll talk about today and one of which we'll talk about on our next podcast.

Mike Melbinger: In the *Weller* case, Weller was the former employee. He had no sooner concluded a $1 million dollar settlement with the Lindy Company, his former employer, over a potential whistleblower claim when he sued the employer again arguing that the million dollar settlement amount should have been taken into account in calculating his supplemental pension that is, under the employer's non-qualified pension plan.

Mike Melbinger: Like many employers, the Lindy Company maintained a qualified pension plan in which all employees participated, and a separate non-qualified supplemental pension plan, which was known as the Excess Program, and that was for highly compensated employees only. The qualified pension plan provided benefits under a formula based on employees' earnings up to the Annual Code Section 401(a)(17) limit, which is $280,000 for 2019. While the Excess Program provided benefits under the same formula but only taking into account an employee's earnings above that $280,000 amount.

Mike Melbinger: Like most non-qualified plans, the Excess Program defined earnings by reference to the definition of earnings in the qualified plan formula. The qualified pension plan in turn defined earnings as the amount received, and I'm quoting here, "By a participant from an employer as base salary or wages, plus bonuses or other regular remuneration for services as an eligible employee."

Mike Melbinger: That definition goes on to exclude, "any other remuneration paid to an employee which the employer determines to be overtime pay, shift differential, premium pay, or ny other form of additional or special compensation." Seems clear enough, right?

Steve Flores: Yeah, that seems pretty clear. So what's the catch?

Mike Melbinger: Well, the catch is that most executive compensation professionals would agree that the company and the drafters of the Excess Program had specifically designed this definition to exclude the type of unusual payments that this $1 million dollar settlement was. However, the court here found ambiguity, in part created by the terms of the settlement agreement. Now under the settlement agreement, the company was to provide Weller with a one-time payment of $1,015,000, and issue an IRS Form W-2 concerning the settlement payment. The settlement agreement specifically stated that, "Its purpose was solely to buy peace and to resolve disputed claims and for no other purpose." That again, was a direct quote.

Mike Melbinger: Nonetheless, the plaintiff argued that the parties to the settlement agreement had intended for the settlement payment to be designated as wages and intended for it to be included in the definition of earnings under the qualified plan and the Excess Program. He based his claim in part on the fact that the company issued him a W-2 for the $1 million settlement payment and on that form it designated the payments as wages, which I think is more or less required, but at any event, I find and found that claim very hard to believe.

Mike Melbinger: But here's the important thing, the standard for a court to grant summary judgment, that is to dismiss the lawsuit without any form of trial, is that there's no genuine dispute as to any material fact and the undisputed facts demonstrate that the moving party is entitled to judgment. So that's a pretty high standard and a lot of these cases go forward where the court can find any ambiguity at all.

Mike Melbinger: The company argued, of course, that the settlement payment was not earnings under the qualified plan or the program because it was well, it's a settlement and it was not provided by the company to Weller for services as an eligible employee. You remember that being part of the definition. But instead, as it said in the agreement, the settlement payment was to buy peace and prevent litigation. In the end, the court found that there

was a material dispute of fact as to whether or not the parties intended the payment to be under the settlement agreement and counted as earnings for purposes of the qualified plan and the Excess Program.

Steve Flores: But Mike, why didn't the court defer to the interpretation of the plan's terms by the company or the administrator? Under an ERISA plan, as we practitioners know, when there's a disagreement about the terms of the plan the aggrieved employee must first file a claim for benefits with the plan administrator. The plan administrator then is able to exercise its discretion, assuming the appropriate language is in the plan, in terms of interpreting the plan, and if the issue later goes to court, the court should uphold the plan administrator's decision unless it finds that the decision has been arbitrary and capricious.

Mike Melbinger: Well Steve, that's a great question. It's not at all clear whether the company's counsel failed to phrase the issue as an interpretation of the terms of an ERISA plan, or two ERISA plans in this case, or whether the court simply whiffed on the issue of whether the plans were subject to ERISA, which they certainly were. You just can't tell from the case, but the moral of the story here is that counsel should take the utmost care in drafting the definition of covered or included compensation or earnings in an excess or other non-qualified retirement plan.

Mike Melbinger: The issue, as I said, of whether certain payments should be treated as covered compensation or earnings under plans has been creating litigation every year for as long as I've been practicing executive compensation law, and that's 36 years. These definitions, these terms must be very precise and ordinarily should expressly exclude any dollars not paid as regular base salary or annual cash bonus generally. And of course, counsel also should ensure that any non-qualified plan is subject to ERISA as a top hat plan as you point out.

Steve Flores: Yes, these are very important lessons for plan sponsors.

Mike Melbinger: Let me talk briefly about a similar issue that arose under a different plan just to show how common this is. This is another 2019 case. It's called *Batty vs. UCAR International*. Mr. Batty had been employed by UCAR for more than 34 years. In 2000, the parties entered into a severance agreement that would provide Batty with payments if he terminated or resigned for good reason following a change-in-control of the company. Well, a change-in-control occurred in 2015 and Batty resigned in early 2017, and the company paid him more than $1 million dollars in severance.

Mike Melbinger: However, in 2018, Batty sued the company seeking an additional $1.5 million dollars, which he believed the company owed him under the severance agreement. The problem was this 2000 severance agreement entitled Batty to the amount of his accrued incentive compensation upon termination and specifically referred to target variable compensation, so Batty argued that target variable compensation must include his 2015 and 2016 equity awards, which the company had not paid. They'd forfeited them, the awards were not vested when he terminated.

Mike Melbinger: Well, the company, as you might expect, argued that the phrase "accrued incentive compensation" should be limited to cash compensation and should exclude the equity awards. The key definition in this severance agreement was that of "incentive compensation," which it defined as, "any compensation, variable compensation, bonus, or benefit." The fact is it just wasn't clear, right? Variable compensation is a term often used to include equity compensation, as is incentive compensation.

Mike Melbinger: The company focused on the phrase "payable in cash" while Batty emphasized the terms "awards" and "variable." The court found in the end that the company's interpretation of the agreement was reasonable but it was not the only reasonable interpretation. The court held and actually stated that it's just as conceivable that the term "incentive compensation" could mean items that were paid in cash or equity, such as the equity awards.

Mike Melbinger: Again, remember, the standard of review, no genuine dispute as to any material fact, so even compensation professionals like us that think we know what words mean and what they're intended to mean here recognize that there's a dispute about the material facts at issue. Now there was evidence on both sides, both parties pointed to selective SEC filings to support their arguments, but again, the SEC filings were capable of different interpretations so this case goes forwards.

Mike Melbinger: The ambiguity in this case, like that in the *Weller* case, could have been resolved by more specificity in the release of claims or settlement agreement. That's what should have happened, but we're more or less out of time on this podcast. We'll cover that in our next podcast.

Steve Flores: Mike, thank you for sharing your thoughts and insights on these drafting tips that will hopefully help employers reduce their risk of litigation. Thank you to our listeners for listening to another edition of Winston's Benefits Blast Podcast. You can subscribe to the Benefits Blast Podcast via Apple, iTunes, or Google Play, or by visiting our website.

Related Locations

Chicago

Related Topics

Podcast

Executive Compensation Plans and Agreements

Employment Law

ERISA Litigation

Related Capabilities

Labor & Employment

Executive Compensation Plans & Agreements

Related Regions

North America

© 2024 Winston & Strawn LLP.