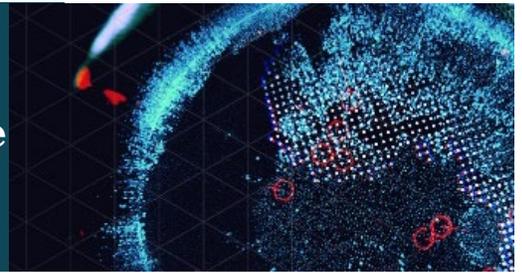


Coronavirus/COVID-19

Managing COVID-19: Reviewing Executive Compensation in Light of COVID-19



April 7, 2020

Boards of directors, compensation committees and executive officers have begun to confront the impact of the COVID-19 pandemic on their compensation programs. This alert highlights key considerations for public companies as they make important decisions regarding these programs.

1

Revisiting Incentive Plan Performance Targets

- Many executives are compensated, in part, based on the satisfaction of pre-determined company financial or operational performance targets that may be harder to achieve as a result of the COVID-19 outbreak. These targets are used in both cash bonus plans and equity awards. As the year progresses, compensation committees may wish to consider whether previously established corporate and individual performance targets remain appropriate to retain and incentivize executive officers to contribute to the company's growth and align with the interests of shareholders. If not, companies may consider whether an adjustment to cash bonus performance incentives, an option repricing or other equity award adjustments would be appropriate.
- If a compensation committee decides to revise incentive plan performance metrics, certain disclosure obligations come into play. First, if such revisions constitute material amendments to the awards in question, the company would be required to disclose the revisions on Form 8-K. Depending on the type of award, material amendments to performance-based equity awards for Section 16 officers could trigger a Form 4 reporting obligation. Finally, revisions to performance objectives made during the current fiscal year, and the compensation committee's reasons for making such revisions, would need to be discussed in the Compensation Discussion and Analysis section of the company's proxy statement in the following year.

2

Accelerated Equity Plan Burn Rates

- Due to the market downturn, many companies will be issuing more shares than anticipated to meet target award values in plans that grant shares with a pre-determined cash value on the grant date, thus depleting share reserves at a faster rate than planned. Companies will need to focus on share reserves and consider actions to off-set accelerated burn rates. For example, companies might consider delaying awards, offering all or a portion of some awards in cash rather than equity, or granting awards contingent upon future shareholder approval of an increased share reserve. Companies may also consider using a price-averaging mechanism when converting target award values into shares as a way of smoothing short-term price volatility, for example, by averaging share price over a period of days rather than relying on a one-day spot price.

- Companies may also need to consider seeking shareholder approval to increase the number of authorized shares available under a plan earlier than they were otherwise considering.
-

3

Underwater Stock Options

- Many companies may have issued stock options that are now significantly underwater. Repricing those options to current fair market value is possible, subject, however, to restrictions in plan documents and stock exchange listing standards. Some plan documents prohibit repricings altogether. Most other public company equity plans and stock exchange listing standards require shareholder approval for repricing stock options. In addition, companies will need to be careful not to jeopardize the stock options' exemption from the deferred compensation rules in Section 409A of the Internal Revenue Code, for example, by discounting the exercise price below current fair market value or by engaging in repeated repricings. Companies that issue incentive stock options (or ISOs) should be careful to ensure that any repriced ISO continues to comply with the applicable tax requirements.
 - As an alternative to a stock option repricing, companies could consider implementing a stock option exchange program, whereby shareholders tender underwater stock options to the company in exchange for a lesser number of new stock options at a lower exercise price, new shares of restricted stock, restricted stock units or similar equity awards. As with a stock option repricing, stock exchange listing standards and most public company equity plans require shareholder approval for this kind of exchange. In addition, unless the exchange program is limited to a small number of executive officers or other holders, the exchange must comply with the Securities and Exchange Commission's (SEC) tender offer rules, which among other things, require the filing of a Schedule TO with the SEC and a minimum offer period of 20 business days.
 - Companies that implement amendments, exchanges or similar modifications of outstanding options, as discussed above, would also need to consider applicable disclosure obligations in connection with such actions, including under Form 8-K, Section 16 and the proxy rules.
-

4

Non-Employee Directors

- Companies considering annual equity grants to non-employee directors will want to think about whether past years' compensation levels continue to be an appropriate guidepost. This may particularly be the case in situations where a company's stock price has declined, but the company does not expect COVID-19 to have a significant long-term effect on its revenues or profitability.
 - In addition, companies with share-based caps on equity plan awards to non-employee directors should review these caps and determine whether target award values might be impacted.
-

5

Modification or Cancellation of Rule 10b5-1 Trading Plans

- The recent market downturn may well have put the minimum permissible price for scheduled sales of stock under Rule 10b5-1 trading plans significantly higher than the current trading prices. Directors and executives wishing to modify their plans must be sure they are not in possession of material non-public information when they do so and also recognize that frequent modifications should be avoided. Also, in the event of any modification, an appropriate waiting period should be implemented before trades can be reinstated under the plan.
 - If permitted under an individual's 10b5-1 plan, the plan may be cancelled when the individual is in possession of material non-public information. However, cancellation could create a suspicion that the plan was not entered into in good faith, and thereby weaken the effectiveness of the 10b5-1 affirmative defense to allegations of insider trading.
-

6

Changes to Deferred Compensation

- Many companies issue awards that are subject to the Section 409A non-qualified deferred compensation rules. These rules heavily restrict a company's or individual's ability to change the time or form of payment, particularly in any way that might accelerate or delay payment from when it would otherwise have been made. Before making any changes to awards already issued, companies will want to consider whether Section 409A will permit the change.
-

7

Withholding Taxes Are Still Due

- Companies have a variety of ways in which they satisfy payroll tax withholding obligations with respect to equity compensation. If a company relies on withholding from non-equity compensation (i.e., the company does not "net settle" or "sell to cover" or some other form of cashless exercise), it should consider whether this approach continues to be sensible. Many employees' monthly cash flow will be impacted in some way by the COVID-19 pandemic. As a result, companies might consider adopting a cashless withholding program.
-

8

Global Considerations

- Many of the issues described above will be relevant not only for the US-based executives and employees of a US company but also for employees abroad to whom equity awards are issued. Because each country is dealing with the COVID-19 pandemic in its own way, careful consideration and monitoring will be needed to ensure continued local compliance for equity compensation programs.
-

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Employee Benefits and Securities and Capital Markets practices:

<u>Kerry Burke</u>	+1 202 662 5297	kburke@cov.com
<u>Christopher DeCresce</u>	+1 212 841 1017	cdecresce@cov.com
<u>David Engvall</u>	+1 202 662 5307	dengvall@cov.com
<u>Michael Francese</u>	+1 202 662 5413	mfrancese@cov.com
<u>Brian Rosenzweig</u>	+1 212 841 1108	brosenzweig@cov.com
<u>William Woolston</u>	+1 202 662 5844	wwoolston@cov.com
<u>David Martin</u>	+1 202 662 5128	dmartin@cov.com
<u>Matt Franker</u>	+1 202 662 5895	mfranker@cov.com
<u>Reid Hooper</u>	+1 202 662 5984	rhooper@cov.com

This information is not intended as legal advice. Readers should seek specific legal advice before acting with regard to the subjects mentioned herein.

Covington & Burling LLP, an international law firm, provides corporate, litigation and regulatory expertise to enable clients to achieve their goals. This communication is intended to bring relevant developments to our clients and other interested colleagues. Please send an email to unsubscribe@cov.com if you do not wish to receive future emails or electronic alerts.