

ENERGY BOOTCAMP SERIES

Session 2: Labor Laws and Executive Compensation

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Presenters



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AGENDA

1. Executive Compensation Trends and Issues in 2013 – Joshua Agen
2. Labor and Employment Refresher – Jeremy Wooden
3. Q&A Session



Executive Compensation Trends and Issues in 2013

Presented By:
Joshua Agen



Pay for Performance

- Trend toward performance contingent long-term incentive compensation continues
 - Nearly 40% of Fortune 1000 companies now use performance shares
 - Performance shares outnumber stock options among the top 250 companies
- Trend toward reducing or eliminating perquisites and tax gross-ups continues



Deferred Compensation Compliance

- Code Section 409A
 - Applies to all “deferred compensation,” defined as a legally binding right in one year to compensation that is or may be payable in a later year
- 409A covers arrangements such as
 - Severance
 - Supplemental retirement plans
 - Some equity arrangements:
 - Discounted stock options
 - Restricted stock units

Deferred Compensation Compliance (Continued)

- Code Section 409A (Continued)
 - Basic idea of 409A is to limit control by service providers (and service recipients) over when income is recognized, taxed and/or deducted
 - Limits take the form of strict rules on when the election to defer compensation must be made and when the compensation may be distributed
 - Penalties for noncompliance are immediate recognition of income, extra tax of 20% on the compensation and interest penalties; and there are additional penalties in some states (e.g., California)

Deferred Compensation Compliance (Continued)

- IRS is auditing for compliance with 409A
 - Information document requests
 - Two voluntary correction programs, but limited availability
 - Not available if the employee is under audit
 - Cannot correct operational errors more than two years after they occur
- IRS will go to court over technical 409A compliance issues
 - In *Sutardja v. United States*, a case involving discounted stock options under 409A, the IRS has prevailed so far
 - Basic 409A rule on nonqualified stock options and stock appreciation rights: they can be exempt from 409A only if the exercise or grant price is no lower than the fair market value of the underlying stock on the date of grant
 - IRS alleged that Sutardja's stock options were granted at a discount and did not comply with 409A; therefore claimed a deficiency of more than \$5 million

Deferred Compensation Compliance (Continued)

- Recommendations:
 - Document clearly the basis for determination of fair market value when granting options, as well as the timing of option grant approvals and the timing of notification to award recipients
 - Consider internal audit of other deferred compensation arrangements for compliance with 409A

Other Legislative and Regulatory Developments

- The Dodd-Frank Wall Street Reform and Consumer Protection Act became law in 2010
- Executive compensation rules apply to publicly traded companies, but affect perceptions of “best practices” for non-publicly-traded companies as well
- Introduced “Say on Pay,” “Say When on Pay” and “Say on Golden Parachutes”
 - 2013 is the third year for Say on Pay
 - Results to date suggest:
 - Vote may increasingly be seen as routine
 - Less than 2% of votes have failed so far in 2013
 - Potentially diminishing influence of proxy advisory services (ISS)

Legislative and Regulatory Developments (Continued)

- Dodd-Frank and Compensation Committees
 - Heightened independence requirements for directors serving on Compensation Committees
 - Requirement to evaluate the independence of advisors from management before engaging
 - Publicly-traded companies must amend Compensation Committee charters effective July 1, 2013 to incorporate advisor independence evaluation

Legislative and Regulatory Developments (Continued)

- More regulations to come
 - Pay-for-performance disclosures
 - Pay ratio disclosures
 - Anti-hedging disclosures
 - Clawbacks

Pay-Related Shareholder Litigation

- Dozens of lawsuits filed against companies who failed “say on pay” votes
- Allegations include:
 - Breach of fiduciary duty
 - Waste of corporate assets
 - Unjust enrichment
 - False or misleading disclosure
- In 2012, new strategy used by plaintiffs attorneys was to file suit prior to the annual meeting, seeking to enjoin the annual meeting to extract a settlement

Pay-Related Shareholder Litigation

(Continued)

- Code Section 162(m) compliance has emerged as another basis for shareholder lawsuits
 - Section 162(m) limits the deduction a publicly-traded company may take for compensation paid to its named executive officers other than the chief financial officer (determined as of the end of each year) to \$1,000,000 per year per individual
 - However, performance-based compensation that meets the requirements of Code Section 162(m) – including shareholder approval of performance goals every five years -- does not have to be included as part of the \$1,000,000 limit, and thus is fully deductible.
- Most cases dismissed at pleadings stage, but there have been some settlements
- Recommendations:
 - Draft disclosures with possibility of litigation in mind
 - Internal audit of Code Section 162(m) compliance



Labor and Employment Refresher

Presented by:
Jeremy Wooden



Employment Law

- Beyond basics (e.g., minimum wage, anti-discrimination), employment laws consist of a cornucopia of often overlooked risks and potential costs
- These laws increase cost of labor, including sometimes increasing the cost of warranted separations from employment
- Often overlooked by small, growing companies



Employment Law Overview

- Common Scenarios
- More Employees, More Problems
- At-Will Issues
- Trade Secrets
- Employee Inventions
- Non-Competition/Non-Solicitation
- Non-Disparagement Clauses
- Wage and Hour Laws
- Leave Laws
- California traps for the unwary



Common Scenarios

- Hourly employee legitimately terminated for poor performance. Files a lawsuit, alleging 32-year old supervisor who fired her was motivated hostility toward plaintiff's age (she is 60). As "evidence" of this hostile intent, Plaintiff vaguely alleges that supervisor treated younger employees more favorably and once complained about employer's "dinosaurs."

Common Scenarios (Continued)

- Disgruntled white collar employee who earned in excess of \$100,000 a year, quits. Months later, the company receives a class action complaint alleging that the employee, and those similarly situated to him, were improperly classified as exempt from overtime requirements. Company is potentially liable for any unpaid overtime, penalties, and attorneys' fees.

More Employees, More Problems

- As the number of Employees grows, so does coverage of labor laws:
 - 1 or more employee – federal and state wage laws (recordkeeping, minimum wage, overtime, etc.) & military anti-discrimination statute;
 - 5 or more employees (California prohibitions on discrimination, harassment, etc.)
 - 15 or more employees (Americans with Disabilities Act (“ADA”) and Title VII)
 - 20 full-time or regular part-time employees - Age Discrimination in Employment Act (“ADEA”) (prohibits discrimination of older workers)
 - *includes both foreign and domestic employees;
 - 50 employees within 75 miles of a worksite (Family Medical Leave Act (“FMLA”) and California Family Rights Act (“CFRA”))
 - 75 employees within last 12 months (Cal-WARN Act)
 - 100 employees (Federal WARN Act)

At-Will Status

- Employment traditionally at-will: employers have broad right to dismiss employees for virtually any reason
- Anti-discrimination, harassment, and retaliation laws curb ability of employers to fire employees for unlawful reasons (e.g., age, race, gender).
- Some states have eroded at-will status (e.g., implied contract doctrine);
- Best practice – include at-will provision in handbook and obtain signed acknowledgment of at-will status. Handbook should state that no company representative, other than the President, may alter at-will status, and only in writing. This will prevent claims that the at-will status was eroded by verbal assurances (e.g., a manager telling an employee during a review that he or she will remain employed as long as the keep up the good work).

Trade Secrets

- California has adopted the Uniform Trade Secrets Act (“UTSA”). The UTSA authorizes the following remedies for misappropriation – injunctive relief, damages, unjust enrichment, reasonable royalty, exemplary damages and attorneys fees. [Civ. Code 3426.3, .4].
 - Examples: customer lists, information related to cost and pricing, marketing strategy, manufacturing technology
- **Trade Secret Defined:** “information, including a formula, pattern, compilation, program, device, method, technique, or process that:”
- (1) “derives independent economic value, actual or potential, from not being generally known to the public or to other person who can obtain economic value from its disclosure or use; and
- (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.” [Civ. Code 3426.1(d)].

Employee Inventions

- An employee's invention that meets the definition of a trade secret may be treated as such.
- ***Employees Hired to Invent*** – “That which he has been employed and paid to accomplish becomes, when accomplished the property of his employer.” [Daniel Orifice Fitting Co. v. Whalen (1962) 198 Cal.App.2d 791 (chief engineer's drawings of manufacturing process for piston-controlled valve)]
 - Includes inventions developed outside of work, on employee's own time.
- ***Employees Not Hired to Invent*** – Employee not hired to create or design product typically own the rights to their inventions, even if their employment provided them with the idea and even if the invention is an improvement on the employer's product. [Rigging Int'l Maint. Co. v. Gwin (1982) 128 Cal.App.3d 594 (mechanic's development of twist-lock system for crane operator not employer's property where employer was a service provider and not a manufacturer)].

Non-Competition/Non-Solicitation

- **Most States**: Covenants not to compete are generally enforceable if reasonably limited in time and geographic scope.
- **California**: Covenants not to compete are generally invalid. [Edwards v. Arthur Andersen LLP (2008) 44 Cal.4th 937]. Generally encompasses even narrow restrictions (e.g., short duration or small geographical scope), agreements penalizing competition (e.g., forfeiture of pension), agreements not to solicit customers,
- **Exceptions** – (1) where covenant not to compete is necessary to protect the employer's trade secrets; (2) covenants not to solicit coworkers may be upheld even if no trade secret is involved (but does not extend to hiring unsolicited former coworkers); (3) covenants not to compete may be upheld where signed by non-employees (e.g., sale of goodwill of business by seller, shareholders, partners).

Non-Disparagement Clauses

- In executive severance packages, a best practice is to condition severance on compliance with non-disparagement agreement (particularly effective where payments structured over time). A company may be more willing to enforce a non-disparagement clause if it is coupled with an arbitration agreement (which will keep the dispute out of the public).
- Recent NLRB Rulings
 - Direct TV required blanket pre-approval of all communications with media
 - caution against overbroad social media policies

Wage and Hour Laws

- Wage and hour – set of laws that govern how work time is measured and how workers are paid for that time.
- Distinction between Salaried and Hourly Employees
 - Distinctions between managerial employees vs. non-managerial (heavily litigated at level of retail managers)
 - Distinctions between “administrative” employees and so-called “production” employees (heavily litigated at level of insurance adjusters)
- Basic principle for Non-Salaried Employees: employees should be paid for all time worked, including time-and-a-half for any time worked over 40 hours in a workweek
- Invitations to class actions:
 - Vague workweek definitions
 - Remote work (e.g., via home computer or smart phone)
 - Off-the-clock (e.g., at work, before or after shifts)
 - Auto-deductions for lunch period
 - “regular rate” component of overtime calculation (should include all forms of non-discretionary compensation)

Leave Laws

- Types of leave
 - family leave
 - Disability leave (as an accommodation in addition to FMLA leave)
 - Military leave
- CA leave
 - Pregnancy
 - “Kin care”

California – Overview of California Traps for the Unwary

- Daily overtime in addition to weekly overtime
- Arbitration clauses
- Meal and Rest Periods
- Record-keeping & Waiting Time Penalties
- Mandatory Sexual Harassment Training
- Credit Checks
- Vacation policies (no “use it or lose it”)
- Expense reimbursements
- Commission agreements & “chargebacks”



Q&A Session

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