

April 2, 2020

Compensation Limits on Corporate Participants in CARES Act Programs

On Friday, March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) became law. Eligible businesses that receive assistance under the CARES Act will be required to limit the compensation of highly compensated employees, and in some instances maintain specific workforce levels, for the duration of the assistance received and a specified period thereafter. Companies wishing to participate in CARES Act programs should give careful consideration to these limitations and requirements, which are based on broad principles that are subject to interpretation and require substantial guidance. Under the CARES Act, the Department of Treasury is required to publish procedures for application and minimum requirements of the programs no later than April 6, 2020 (*i.e.*, 10 days after enactment of the CARES Act). We are optimistic that the Treasury will issue clear guidance on these topics to ensure that businesses receive urgently needed assistance with as little friction as possible, maximizing the positive impact of the stimulus for all Americans.

Overview of Compensation Limitations. To receive financial assistance (in the case of air carriers and contractors), or loans and loan guarantees (in the case of other eligible businesses), a company must agree to the following limits (which generally apply during the period of assistance and for one year thereafter) on annual compensation and severance payments for each officer and other employee (other than a unionized employee) whose “total compensation” exceeded \$425,000 in 2019 (“CARES Act HCEs”):

- Each such individual cannot receive total compensation during any 12 consecutive months in excess of the lesser of:
 - the total compensation received by the individual in 2019; and
 - the sum of (i) \$3,000,000; and (ii) 50% of the amount that the individual’s total compensation in 2019 exceeded \$3,000,000.
- Severance pay or other benefits upon termination of employment cannot exceed two times the maximum total compensation received by the CARES Act HCE in calendar year 2019.

Assuming the Treasury expeditiously implements programs or facilities supporting loans by private sector lenders under the \$454 billion pool not targeted to specific industries, companies will be able to avail themselves of much needed relief without being subject to the compensation limitations, since the compensation limitations only apply if the company receives from the Treasury a “loan, loan guarantee, or other investment . . . as part of a program or facility that provides direct loans.” The statute defines a “direct loan” as a “loan under a bilateral loan agreement that is (i) entered into directly with an eligible business as borrower and (ii) not part of a syndicated loan, a loan originated by a financial institution in the ordinary course of business, or a securities or capital markets transaction.”

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Definition of Total Compensation. The CARES Act defines “total compensation” as “salary, bonuses, awards of stock, and other financial benefits provided by an eligible business to an officer or employee of the eligible business,” but does not define any of the individual compensation elements. The statutory language raises questions as to how and when different components of compensation should be valued. For example, is the compensation represented by an award of equity compensation received when granted, upon vesting, or upon settlement? How should its value be determined? While the statute leaves these questions unresolved, we anticipate Treasury will address them, perhaps by utilizing the definition of compensation required to be disclosed in summary compensation tables applicable to named executive officers of public companies, excluding, for this purpose, actuarial increases in pension plans and above-market earnings on deferred compensation. Such an approach would be consistent with the approach under the TARP regulations promulgated under comparable circumstances a decade ago, and would ensure a clear and consistent method for determining CARES Act HCEs that enables public companies to rely on familiar principles, minimizing additional administrative burdens. It would also seem appropriate for 2019 “total compensation” to be annualized or adjusted to avoid penalizing employees who were hired or promoted during 2019.

Treatment of Preexisting Contractual Entitlements and Obligations under Law. Preexisting contractual and legal commitments (other than pursuant to a collective bargaining agreement) are not specifically addressed in the CARES Act compensation limitations. For large companies, the \$425,000 total compensation threshold may capture hundreds of employees, some of whom are employed in jurisdictions outside of the United States, where compensation levels may be statutorily protected. An eligible business may face the difficult choice of breaching contracts or applicable law or of spending limited time and resources seeking waivers from a large number of CARES Act HCEs, jeopardizing, in either case, the prompt delivery of urgently needed relief. For these reasons, it would be practical if preexisting contractual commitments and obligations under non-U.S. law (whether statutory or as a result of works council rights) could be excluded from the compensation limitations, similar to the exception for employees whose compensation is determined through a collective bargaining agreement in the United States.

Previously Announced Reductions in Force. The CARES Act requires that eligible companies maintain employment levels of at least 90% of those levels in effect on March 24, 2020. When considering how to apply this standard, it may be useful to recall that corporations depend on strategic planning and fiscal budget processes that may call for critical actions over the course of the fiscal year, including planned employee terminations. To that end, layoffs or other reductions in force, furloughs or other similar types of job eliminations that were announced, budgeted or noticed on or before March 27, 2020 (*i.e.*, the date the CARES Act was enacted) could be disregarded for purposes of applying this standard. To require companies to undo long-planned strategic initiatives

may hamper a company's ability to recover from the unprecedented challenges facing the business community today.

Employment and Compensation Commitments. The CARES Act requires mid-sized businesses (generally, employers with between 500 and 10,000 employees) who receive financial assistance under the mid-sized business relief program to, among other things, (1) use the funds to retain at least 90% of the borrower's workforce at full compensation and benefits until September 30, 2020, (2) restore not less than 90% of its workforce that existed as of February 1, 2020 and (3) restore all compensation and benefits to workers within four months following termination of the coronavirus health emergency declaration. Business owners need substantial guidance regarding the application of these principles. In the past week, dozens of companies have announced compensation reductions for executives, employees and directors and workforce furloughs in an effort to ensure the long term viability of these enterprises. It is essential that a clear set of rules be established so that these companies understand whether actions they take to survive will disqualify them from CARES Act assistance.

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Companies considering participation in the CARES Act programs should inventory employee compensation levels and arrangements to identify the scope of covered employees and actions necessary to ensure compliance with the rules. Companies should also closely monitor Treasury guidance, with the retrospective that the initial terms of TARP assistance in 2008 were retroactively modified in 2009 primarily to expand the compensation restrictions. The Treasury has a tall task to accomplish in a short period, and we are hopeful that it will engage with all relevant constituencies and compensation experts to develop workable parameters that facilitate the stimulus required to bolster businesses weakened by an unprecedented crisis and shore up the U.S. economy. Eliminating unnecessary impediments to urgently needed financial assistance will fortify the impact of the vital CARES Act legislation.

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