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ISSUES AND CONSIDERATIONS INVOLVING THE RECOVERY OF EXECUTIVE OFFICER COMPENSATION

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At the recent meeting of the Employee Benefits and Executive Compensation Subcommittee at the ABA's Business Law Fall meeting, moderators identified several hot topics stemming from the new compensation recovery (clawback) policies required to be adopted by listed companies by December 1, 2023.

Discussion topics during the meeting included:

• In the case of stock that vested upon the achievement of performance targets, the value that the Committee may seek to recover if the executive officer already disposed of the shares that are deemed erroneously awarded compensation.

As background, the SEC provided guidance that where the shares had not been sold by the executive at the time of recovery, the erroneously awarded compensation to be repaid is the number of the shares received in excess of the number that should have been received applying the restated financial reporting measure. (See page 79 of SEC the SEC's final Rule Release (the "Rule Release")). However, the SEC did not include in the rule release any requirement on the amount of shares/value to be recovered if the shares had been sold, other than as indicated below. Comments received by the SEC on the compensation recovery rule proposal recommended the recoverable value in these circumstances be calculated as, among other recommendations:

- the FMV of the shares determined to be erroneously awarded compensation on the date the number of such shares is determined, or if the shares were gifted, the FMV on the date of the gift;
- the cash value to be calculated at the time the shares are "received" as determined under the rule, to avoid giving an incentive to executives to sell shares immediately upon vesting; and
- the cash amount of the shares' value on the date the issuer is required to prepare a restatement.

See page 97 (including footnote 291) of the Rule Release.

Instead, of providing any specific formula to calculate the number of shares/value in this circumstance, the SEC simply stated that Rule 10D-1 does not limit the amount of compensation the board is required to recover, other than that they may not settle for less than the full recovery amount unless they satisfy the conditions that demonstrate recovery is impracticable.   The SEC also noted that many different means of recovery may be appropriate in different circumstances, but that in exercising discretion in the recovery of compensation, "issuers should act in a manner that effectuates the purpose of the statute: to prevent current or former executive officers from retaining compensation that they received and to which they were not entitled under the issuer's restated financial results." Based upon the final rule, it seems uncertain how issuers will determine the value to be recovered in the event that shares that are sold at an appreciated value, are later determined to be erroneously awarded compensation.

• If an executive officer falls out of compliance with a company's stock ownership guidelines following the recovery of stock determined to be erroneously awarded compensation, how will a board/committee administering the ownership guidelines handle the noncompliance?

Practical suggestions made by the moderators included:

- Review compensation documents (e.g. equity plans and award agreements and employment agreements) to ensure that:
  - if more than one compensation recovery policy is maintained by a company (e.g. the mandated policy and a separate policy that may cover a broader employee population or provide for additional grounds for recovery), such compensation document includes reference to multiple policies rather than a single policy.
  - in the case of employment agreements or other agreements that provide separation benefits for a "good reason" resignation, ensure that recovery of erroneously awarded compensation would not trigger such right.

- Companies are cautioned to not try to offset recovered erroneously awarded compensation by providing increased amounts of alternative compensation, as this may create the appearance of indemnification of the executive officer.

In addition to the topics covered at the ABA meeting, the issue of recovery of erroneously paid compensation in the case of the death of an executive officer has not explicitly been addressed by the SEC and stock exchanges (i.e., whether a company is required to seek recovery from heirs, executors or administrators). Hopefully, the SEC or stock exchanges will provide interpretive guidance on this and other questions that may arise in the recovery of erroneously awarded compensation.

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