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COVID-19 Impact on Executive Compensation (Leave of Absence)

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COVID-19 has had significant impacts on all aspects of business. While employers are assessing how to handle immediate employee needs related to sick leave, family leave and benefits claims, employers should also consider the impact that changes in their workforce or economic conditions will have on their compensation plans and programs.

This blog post addresses one of those compensation issues that many companies are currently grappling with – whether a temporary leave of absence or furlough triggers forfeiture, payment, vesting, or other treatment under compensation arrangements.

In following blog posts, we will address other compensation issues, including:

- Effect of salary reductions on compensation arrangements (including "good reason" triggers);
- Limitations on amendment of equity awards and performance goals; and
- Funding and termination of nonqualified deferred compensation plans ("NQDC plans") and limitations on such actions.

Is a leave of absence or furlough a "termination of employment" or "separation from service"?

Many employment agreements, severance plans, equity awards and other compensation arrangements provide for partial or full vesting or payment of amounts upon an employee's termination of employment or separation from service.

Although many employees have experienced a significant decline or cessation of work in connection with the COVID-19 outbreak, such employees may not have necessarily had a separation from service or termination of employment under the terms of the applicable compensation arrangement.

As a general matter, employers with compensation arrangements with separation from service or termination of employment triggers who have employees who are being placed on leave, reduced hours or furlough should take the following steps, preferably **before** or as soon as possible after implementing any workforce changes:

- **REVIEW** compensation arrangements:
  - What is the definition of "termination"?
  - What are the effects of a separation from service or termination of employment on the compensation arrangements?
- **IDENTIFY** any employees covered by the compensation arrangements:
  - What type of leave is being taken by the employee or category of employees?
  - What is the start date of the leave?
  - How is the leave being treated for other purposes (*g.*, state labor law, health and retirement plans)?
  - Does the employee have a right to re-employment?
- **ACT** to vest, pay or cause the forfeiture of compensation as prescribed by the compensation arrangement (*g.*, by action of a company's board or compensation committee).

If a "termination of employment" or similar concept is defined in the compensation plan or document, the employer should review and understand the definition and the effect of the definition on its compensation arrangements.

Sometimes, the definition is general (*e.g.*, "a termination of employment as determined by the company other than an approved leave of absence"), but in other compensation programs, it may be defined by reference to a "separation from service" under Section 409A of the Internal Revenue Code ("409A").

If the definition of "termination of employment" is defined by reference to a "separation from service" under 409A, the employer should be mindful that the rules under 409A are complex and technical.[1] Whether a termination of employment has occurred under 409A is based on whether the facts and circumstances indicate that the employer and employee reasonably believe that no further service will be performed, including as an independent contractor. The employer should be mindful of the following:

- A termination of employment under 409A is **presumed** when the level of bona fide service that the employee would perform is permanently reduced to no more than 20% of the average level of bona fide services provided by that employee in the immediately preceding 36-month period.
- **No** separation from service occurs if an employee is on a bona fide leave of absence. A bona fide leave of absence occurs when:
- there is a reasonable expectation that the employee will return to perform services for the employer; and
- either (a) the leave of absence does not exceed six months (or 29 months for certain medically determinable physical or mental impairments) or (b) the leave of absence exceeds six months but the employee has a contractual or statutory right to reemployment.

An employer may take action to affirmatively terminate an employee's employment during a bona fide leave of absence, but the leave itself is not a separation from service. Once the exception for the bona fide leave of absence expires (i.e., the end of the six or 29-month period or the end of the right to reemployment), the employee automatically has a separation from service. How separation from service is defined will dictate the treatment of the compensation under the arrangement. For example, if payments will be made or whether vesting continues.

Proskauer's cross-disciplinary, cross-jurisdictional Coronavirus Response Team is focused on supporting and addressing client concerns. Visit our Coronavirus Resource Center for guidance on risk management measures, practical steps businesses can take and resources to help manage ongoing operations.

[1] The separation from service rules under 409A can be complex. This article addresses separation from service for employees only and does not cover the complexities of when independent contractors and directors have a separation from service.

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