

Considerations When Reducing Executive Salaries

“In the wake of the market disruption caused by the COVID-19 outbreak, a number of employers have announced temporary salary reductions as a means of conserving cash, and thus demonstrating sound stewardship. This memorandum discusses key considerations for companies and boards that are contemplating a salary reduction program for members of executive management,” discuss John J. Cannon III, Doreen E. Lilienfeld, Gillian Emmett Moldowan, Matthew Behrens and Max Bradley in Shearman & Sterling’s *Perspectives*.

“Companies considering implementing a base salary reduction for executives should begin with a careful review of their existing contractual requirements to determine whether the reduction could trigger the right of an executive to terminate employment for ‘good reason.’ ‘Good reason’ (or constructive termination) rights may arise under employment agreements or in severance plans. ‘Good reason’ triggers may also engender consequences under equity or incentive compensation arrangements and deferred compensation plans.”

“Each arrangement that includes a ‘good reason’ construct should be analyzed to determine whether the contemplated reduction in base salary could trigger an argument of constructive termination. The company ought to consider whether the salary reduction is significant enough to cause a trigger if the ‘good reason’ definition is qualified by materiality and if ‘good reason’ is triggered when the salary reduction is part of an across-the-board program that reduces salaries for the entire company or similarly situated employees. If it is determined that the salary reduction could trigger ‘good reason,’ employers should seek consent and waivers from the executives before proceeding.”

Read the article.