# Brownstein Trial Victory Provides Executive Compensation Plan Guidance

Brownstein Hyatt Farber Schreck attorneys and their client recently scored another trial victory. The outcome provides lessons for Brownstein's clients that utilize variable compensation plans for their executives.

Brownstein's trial attorneys represented a large financial services firm that was sued by one of its sales executives. The executive sought to recover seven figures of variable compensation which he alleged he was owed under the client's written variable compensation plan ("VCP").

The firm's VCP provided compensation percentages that the executive could earn on certain sales. However, the VCP also repeated in mantra-like fashion that the firm retained discretion to modify the stated percentages and that it could change or even eliminate the payout percentages at any time, even after a sale had closed and even after payments under the VCP had been made (in which case the firm could claw back payments). Despite this language, the executive sued the client alleging that he had earned the compensation and was entitled to be paid the full amount under theories of contract, promissory estoppel, and under the Colorado Wage Claim Act.

A three-person arbitration panel of the Financial Industry Regulatory Authority ("FINRA") heard the matter over a four-day period in January 2014. Numerous witnesses testified for both parties. On February 13, 2014, the panel issued a written award rejecting the executive's claims in their entirety.

A number of factors contributed to Brownstein's client's success, one of which was the language of the VCP. Indeed, the client's careful drafting of the VCP permitted the trial team to make the persuasive legal and factual arguments that resulted in victory. Any business with variable compensation plans can benefit from the insights learned at the hearing that ultimately permitted the VCP to withstand challenge. Brownstein's attorneys recognize that designing incentive plans is a complex process and that each company's management must exercise judgment to determine how it believes its employees are most effectively motivated. Balanced against those considerations, the trial team offers the following key takeaways from the arbitration:

- *Commission schedules should be expressly subject to management discretion*: If a VCP provides a presumptive commission schedule for sales or for passing stated milestones, the VCP should clearly state that management has discretion to vary or even eliminate the commission amounts. Proximity of the discretionary language is important. Do not relegate the discretionary language to the back of the VCP. Instead, the discretionary language should immediately follow the presumptive schedule and may be repeated again later in the policy.
- *Absolute discretion may be more than discretion*: Case law from various jurisdictions draws distinctions between the term "discretion" and the phrases "absolute discretion" and "sole discretion." To evidence an intent to reserve unfettered discretion to management, regardless of the reason for the decision, VCPs should use the ***broadest*** language possible, such as "sole and absolute discretion."
- *Avoid conditioning management's exercise of discretion on specific criteria*: Tying discretion to criteria, while tempting from an employee expectations perspective, should be avoided because it allows an employee to argue that discretion should be restricted to the enumerated circumstances. For instance, if a VCP reserves

sole and absolute management discretion in one provision, and in another provision states that discretion may be applied in exceptional circumstances, the employer may be forced to later defend a compensation decision by arguing that an exceptional circumstance existed.

- *Expectations should be managed explicitly to avoid reliance arguments*: Employees may not rely on language *where the reliance is contrary to any reasonable expectation that the VCP could have created. Expectations can be managed by explicitly stating that plan participants may not rely on presumptive schedules set forth in the VCP.*
- *Employee acknowledgment should only be used to document plan receipt and review: Employers are wise to document the fact that employees have received a copy of their applicable VCP and that each employee has read the document. This review and acceptance is often documented with a signature or email response. Be careful to explicitly state that the employee is not agreeing to a contract and that the company does not intend to be bound to a contract. The acknowledgement request should state that it is solely for the purpose of documenting receipt and review of the plan.*
- *VCPs are not contracts: When management reserves the right to amend or terminate a plan in its sole and absolute discretion, the VCP will not evidence an intent to be bound. With no intent to be bound, there cannot be a contract. Nonetheless*, employers are wise to go one step further and explicitly state that the plan is not a contract and that its terms cannot be relied on or enforced against the company.
- *Management should reserve discretion to amend or terminate*: Reserving sole and absolute management discretion to terminate or amend the VCP is critical because it informs the employee that it would be *unreasonable to rely on the plan's provisions. Moreover, the VCP should provide that such amendment or termination may occur at any time, including after sales have been made or other targets have been attained by the employee under the presumptive schedule.*
- *The terms "earned," "vested" and "determinable" should be used sparingly: Employers should only use these three words when describing payments that are no longer subject to adjustment. These terms are specifically identified in the Colorado Wage Claim Act and can cause unintended consequences when used without careful consideration.*
- *Management should reserve the right to make adjustments after payments have been made: There may be instances when management at one level awards an employee compensation under a VCP that more senior management subsequently decides to adjust. The company should include language in its VCP giving management the right to make such adjustments in its sole and absolute discretion. It may be advisable to limit such discretion to a reasonable time frame.*
- *The company should explicitly retain the right to recoup overpayments but should consult with counsel before doing so*: In the event that an employee is overpaid under a VCP, careful drafting can provide the company with an opportunity to recover the overpayment from the employee. VCPs should explicitly provide companies with the right to make such deductions or to demand the return of any such overpayments. In certain states, additional employee authorization may be required before deductions may be made.

The recommendations above are general descriptions of best practices for crafting defensible VCPs. Employment laws in your state may vary your ability to use certain types of provisions, so you should consult with your attorney when drafting and revising your VCP.

*This document is intended to provide you with general information regarding variable compensation plans. The contents of this document are not intended to provide specific legal advice. If you have any questions about the contents of this document or if you need legal advice as to an issue, please contact the attorneys listed or your regular Brownstein Hyatt Farber Schreck, LLP attorney. This communication may be considered advertising in some jurisdictions.*

**John V. McDermott**
Shareholder
jmcdermott@bhfs.com
T 303.223.1118

**Jeffrey D. Felder**
Associate
jfelder@bhfs.com
T 303.223.1205

**Carrie E. Johnson**
Associate
cjohnson@bhfs.com
T 303.223.1198

**Lisa Hogan**
Shareholder
lhogan@bhfs.com
T 303.223.1185