SHEPPARD MULLIN
SHEPPARD MULLIN RICHTER & HAMPTON LLP
Labor & Employment Law BLOG
Up-to-date Information on Labor and Employment

11 | 3 | 2009 Posted By

California Supreme Court Upholds Voluntary Employee Incentive Compensation Plan

On November 2, 2009, the California Supreme Court handed down its decision in Schachter v. Citigroup, Inc. At issue was Citigroup's voluntary employee incentive compensation plan that provided employees with shares of restricted company stock at a reduced price in lieu of a portion of the employee's annual cash compensation. Under the Plan, the employees voluntarily agreed that, should they resign or be terminated for cause before their restricted shares of stock vest, they would forfeit the stock and the portion of cash compensation they directed be paid in the form of the restricted stock.

The Supreme Court ruled that the Plan's forfeiture provision did not violate California Labor Code sections which require that employees be paid all earned, unpaid wages on termination or resignation and prohibit agreements that purport to circumvent that requirement. The Court concluded that the forfeiture provision did not run afoul of the Labor Code because no earned, unpaid wages remained outstanding on termination according to the terms of the Plan.

By way of background, under the terms of the Plan, if an employee remained in Citigroup's employ for the two years following the purchase of restricted stock, title to the shares vested fully with the employee, free of any restrictions. However, if an employee voluntarily terminated employment or was terminated for cause before the end of the two-year period, the employee forfeited his or her restricted stock as well as the percentage of annual income designated by the employee to be paid as shares of restricted stock. In contrast, if an employee was involuntarily terminated without cause, the employee forfeited his or her restricted stock, but received, without interest, a cash payment equal to the portion of his or her annual compensation that had been paid in the form of restricted stock.

Mr. Schachter voluntarily terminated his employment with Citigroup. Because Mr. Schachter's resignation occurred before the vesting dates of his restricted stock, he forfeited all of his shares of stock and the percentage of his annual compensation he had directed be paid to him in the form of restricted stock. When he did not get his money back, Mr. Schachter filed a class action against Citigroup alleging a variety of Labor Code violations.

Rejecting Mr. Schachter's arguments, the Court concluded that Mr. Schachter had been paid all of his earned wages – some in the form of restricted stock with an immediate right to vote and earn dividends, and some in the form of cash compensation. According to the Court, when Mr. Schachter executed the Plan's election forms, he essentially renegotiated the terms of his compensation with Citigroup. Mr. Schachter elected to be compensated with a mixture of cash and restricted stock. He understood that the restricted stock he opted to receive would have limited and conditional present value and would not fully vest until two years following the date he received it, provided he remained employed by Citigroup. He elected not to remain for the designated period. Accordingly, the Court concluded that Mr. Schachter did not earn – and thus had no right to receive – either the restricted stock or the funds used to purchase it. The Court did note that had Mr. Schachter been involuntarily terminated by the Company without cause, he would have been required to forfeit his shares of restricted stock in exchange for a cash payment equal to the portion of his or her annual compensation that had been paid in the form of such forfeited restricted stock.

The Court concluded that it was Mr. Schachter's decisions, not the Company's, that resulted in the loss of Mr.

Schachter's contingent incentive compensation. This decision is welcome confirmation for California emp that these types of voluntary employee incentive compensation plans are permissible if they are properly drafted.