HUNTON& WILLIAMS

Client Alert

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Golden Parachutes and Indemnification, Part I

In this Part I of a two-part client alert on golden parachutes and indemnification, we take a look at some lessons learned from navigating the golden parachute regulations before the Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation ("FDIC"). The bottom line is this: the golden parachute regulations are exceedingly complex, and their application to any one bank's situation will vary depending on the particulars of a bank's compensation practices, the nature of the proposed payment, and the condition of the bank or holding company.[1]

Broadly speaking, a golden parachute is (i) any payment, or agreement to make a payment; (ii) that is in the nature of compensation; (iii) that is contingent on, or by its terms is payable on or after the termination; (iv) of such party's primary employment; (v) that is received on, after, or in contemplation of the bank being troubled; and (vi) that is payable to an institution affiliated party whose employment was terminated when the bank was, or was in contemplation of being, troubled.

Here are some things to keep in mind when thinking through the application of this complex definition to your particular circumstance.

1. Do the regulations cover both payments and agreements to make payments?

Yes. If a bank intends to enter into an agreement to make a golden parachute payment, prior non-objection from the FDIC and the bank's primary federal regulator is required. The flipside of this requirement of prior regulatory non-objection for both agreements and payments is that an agreement may have qualified as a golden parachute payment at the time the agreement was entered into, but when it comes time to make the payment under that agreement, the payment may no longer qualify as a golden parachute payment if the condition of the bank has sufficiently improved and the bank is no longer troubled.

2. What is meant by "in the nature of compensation"?

It is not clear. While the FDIC has consistently taken the position (and courts have generally agreed) that "the term 'compensation' was intended to be broadly construed,"[2] the term does have its limits. According to the FDIC's FIL-66-2010, the golden parachute restrictions "do not apply to the payment of salary or bonuses."[3] The regulation itself carves out from the definition payments made pursuant to various types of employee retirement plans and bona fide deferred compensation plans.[4] Moreover, equity put options in employment contracts should not be considered "in the nature of compensation," especially where the equity represents an employee's own invested capital (such as where a founding

[1] For the sake of simplicity, we will use the term "bank" to refer to both a bank and a bank holding company.
[2] *Harrison v. Ocean Bank*, 614 Fed. Appx. 429, 434 (11th Cir. 2015).
[3] FIL-66-2010, footnote 2. Available at https://www.fdic.gov/news/news/financial/2010/fil10066a.pdf
[4] See 12 C.F.R. § 359.1(f)(2).

CEO contributes equity funds to a de novo institution) or where the put option relates to bank holding company equity.[5]

3. Can a payment to settle threatened or ongoing employee litigation be considered a golden parachute payment?

Sometimes. In 2015, the 11th Circuit upheld the FDIC's determination that a pre-litigation settlement payment for claims of alleged torts, whistleblower retaliation, and violations of the Civil Rights Act of 1964 constituted a golden parachute payment. One of the reasons provided by the FDIC in their initial determination that the settlement constituted a golden parachute payment was that "material the Bank provided to support the settlement does not make a compelling case to settle the matter at this time."[6] This reasoning suggests that whether a settlement payment constitutes a golden parachute may turn on whether the FDIC determines there is a "compelling case" for a settlement. In *Harrison*, the FDIC further concluded that "a payment to avoid litigation that otherwise satisfies the definition of a golden parachute is covered by the regulation."[7] On the other hand, the FDIC appears to take the position that "Congress did not intend the golden parachute rules to preclude damages based on *discrimination or other statutory claims* [emphasis added]."[8] If a troubled bank is contemplating a settlement payment to an ex-employee, the bank should carefully consider whether the settlement could be considered a golden parachute payment.

4. What is meant by "contingent on, or by its terms is payable on or after the termination"?

While the phrase is somewhat ambiguous, courts have generally held that the right to payment must arise as a result of the employee's termination. In other words, it is not enough that the payment occurs at some moment in time following the employee's termination—the right to payment must be the result of the employee's termination. Courts can sometimes be unclear on this point. For example, in a case involving a breach of contract claim for severance payment, one court has said "[i]t is clear that the termination payment sought [by the employee] is payable after [the employee's] termination with [the bank], thus satisfying the condition set forth in Section 359.1(f)(1)(i)."[9] However, the real reason why Section 359.1(f)(1)(i) was satisfied in this case was not because the payment happened to occur after the termination of employment, but because the payment that was the subject of the dispute was a severance payment under the terms of the employment agreement.

5. Is a stay put agreement a golden parachute payment?

Yes, if payment of the stay put benefit is contingent on termination and the agreement otherwise qualifies as a golden parachute payment. However, if the trigger for the payment is remaining with the bank through a specific period of time (or the accomplishment of some objective) and the stay put agreement is silent on termination, then the stay put agreement should not be considered a golden parachute payment.

[5] A separate regulatory regime, 12 C.F.R. § 225.4(b), governs the permissibility of a bank holding company purchasing or redeeming its own securities. We are not aware of any authority or guidance on whether put options constitute "compensation" for purposes of the golden parachute rules.

[6] *Harrison* at 433.

[7] *Harrison* at 434.

[8] *Rohr v. Reliance Bank*, 826 F.3d 1046, 1051 (8th Circuit 2016). *See also Rohr* at 1050 ("The agency has consistently held that [the golden parachute rules do] not preclude payment of damages for statutory claims. It has not taken the same position with regard to contract claims. . . the agency's distinction between statutory and contract claims is reasonable.").

[9] *In re NetBank, Inc.*, 2010 Bankr. LEXIS 4462, 13 (Bankr. M.FL 2010).

6. How can I determine what is an employee's *primary* employment?

The regulatory definition of a golden parachute payment covers a payment contingent on the termination of an individual's *primary* employment. As far as we know, there is no public authority on how to determine an employee's primary employment, though the concept of primary employment was acknowledged, but not analyzed, in at least one court case.[10] In situations where an employee has multiple positions with an institution or is employed by both a bank and its holding company, identifying that employee's primary employment may become important in determining whether a payment constitutes a golden parachute payment.

7. What is meant by "in contemplation of"?

We are not aware of any public authority on this question. However, an argument by analogy may be persuasive here. In the context of Regulation W,

> A transaction between a member bank and a nonaffiliate is presumed to be "*in contemplation*" of the nonaffiliate becoming an affiliate of the member bank if the member bank enters into the transaction with the nonaffiliate after the execution of, or commencement of negotiations designed to result in, an agreement under the terms of which the nonaffiliate would become an affiliate.[11]

By analogy, this definition from Regulation W suggests that a bank must have some knowledge that it will soon qualify as troubled in order for it to be said that a golden parachute payment is "in contemplation" of being troubled. For example, the holding company must be in the process of preparing a bankruptcy petition, or a bank must have already been notified of a forthcoming CAMELS composite rating of a 4 or a 5.

8. Must a bank be troubled (or in contemplation of being troubled) at the time the employee was terminated in order for the payment to constitute a golden parachute payment?

Yes. This prong of the golden parachute payment definition is sometimes overlooked, possibly because this prong is *not* in the statutory definition of a golden parachute payment.[12] It is not enough to show that a payment is compensation, is payable contingent on termination, and that the payment would be received on, after, or in contemplation of the institution being troubled. In order to qualify as a golden parachute payment, it must be the case that the institution was troubled (or in contemplation of being troubled) *at the time the employee was terminated*.

A helpful case on this issue comes from the bankruptcy court for the middle district of Florida.[13] In that case, a former employee who was terminated from an insured depository institution holding company approximately eight months before the company filed a Chapter 11 bankruptcy petition filed a general unsecured non-priority proof of claim under his employment agreement with the company. The former employee argued that the company owed him severance payment under his employment agreement. The bank holding company argued that the claim should be "disallowed in its entirety pursuant to 11 U.S.C. § 502(b)(1) because it is a golden parachute payment and is therefore not allowable under non-bankruptcy law." The court disagreed, concluding that "because at the time [the employee] was

[10] *Harrison* at 437 ("Furthermore, the regulation adopts a broad interpretation of the statue's use of the word 'termination,' *see* 12 U.S.C. § 1828(k)(4)(A)(i), by specifying that the 'termination' of an employee includes the termination of the employee's 'primary employment' (and, thus, not necessarily all employment) with the bank.").

[11] 12 C.F.R. 223.3(t).

[12] *See* 12 U.S.C. § 1828(k)(4).

[13] *In re NetBank*.

terminated, Debtor did not satisfy [12 C.F.R. § 359.1(f)(1)(iii)], the payment to [the employee] is not a golden parachute payment."

9. What happens if there is a contractual obligation to pay an ex-employee and the regulators say that payment is prohibited by the golden parachute rules?

A bank is not permitted to make a payment that the regulators say is prohibited by the golden parachute rules, even if that payment is required under an employment contract. In some cases, an ex-employee to whom the payment is owed might sue the bank for breach of contract. The bank will then, typically, acknowledge the obligation, but argue that its obligation to perform is excused under the doctrine of impossibility. Courts have recognized the defense of impossibility against breach of contract claims for payments the regulators have determined are golden parachute payments, but only if the bank has asked for, and been denied, permission from the regulators to pay the golden parachute payment under 12 C.F.R. § 359.4(a)(1) (or if the bank is not able to make the certification required under Section 359.4(a)(4) for such a request).[14] It is unclear to us whether successfully invoking the defense of impossibility permanently discharges the obligation to pay or only suspends the obligation to pay until such a time when payment would no longer be considered a golden parachute payment.

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We hope this alert has been helpful in drawing out some of the subtleties of what is covered under the definition of a golden parachute payment. Should you have any questions in this area, please feel free to contact either of the authors listed below.

Authors

Carleton Goss
cgoss@hunton.com

Nathaniel B. Jones
njones@hunton.com

[14] *See Hill v. Commerce Bancorp, Inc.*, 2012 WL 694639 at 10 (D.N.J. 2012) ("Because there remains a genuine question of material fact as to whether or not Defendants are able to make the Section 359.4(a)(4) certification on Mr. Hill's behalf, Defendants cannot be afforded summary judgment on their contractual impossibility defense.").