



Post #57: The Impact of Recent Pay Actions on Severance Arrangements

From Tom McNeill, Partner, The Woodlands, Texas

Our recent posts have summarized a range of compensation actions across the oil and gas industry that companies have either announced or are considering in response to the current market environment. These actions have included pay reductions, work furloughs, and layoffs. Among other matters, companies likely need to evaluate the impact of these actions on severance benefits.

Multiple types of arrangements provide for cash and other benefits in the event of an employee's or executive's severance, including severance plans, severance guidelines, employment agreements, severance agreements, and equity award agreements. Now may be a good time to review these arrangements. Below are some guiding thoughts when reviewing severance arrangements.

General severance arrangements

Cash severance benefits are often calculated as a multiple of the individual's base salary. Therefore, companies should determine if a temporary reduction in base salary will cause an inadvertent reduction in cash severance benefits for a severed employee. In our experience, the most common definition of base salary in severance arrangements is fairly generic and reads something like: "annualized base salary immediately prior to the date of termination" (may be weekly or monthly for non-executives). This simple definition, however, does not specifically address a temporary reduction to base salary of the like we are currently seeing.

Companies should confirm that the definition of base salary is written in a way that results in a severance benefit that aligns with the company's objectives. If, for example, a company wishes to ensure that the level of employee severance benefits is not affected by the current wave of short-term salary reductions, the company should consider amending the definition of base salary to disregard such reduction and determine severance benefits based on an employee's salary rate in effect immediately prior to the salary reduction.

As a general matter, a furlough would not change the employment status of an employee. Therefore, furloughed employees would likely still be deemed as eligible to participate in severance arrangements. But depending on the severity and duration of the current situation, some furloughed employees may ultimately be laid-off. Companies should confirm severance arrangements specify that a furloughed employee's rate of pay (i.e., annualized base salary, hourly/weekly wage) did not change, but was instead only subject to a temporary reduction.

Change-in-control (CIC) severance arrangements

While depressed share prices and the search for cost efficiencies might prompt industry consolidation in the near-term, it would seem that M&A activity in the oil and gas industry is more likely to take place following a round of restructurings, perhaps 4-6 months from now.

If separate from general severance arrangements, CIC severance arrangements should also be reviewed for similar definitional amendments as noted above. However, we advise that amendments focus on clarification in light of the current situation, and avoid enhancements such as the addition of a single-trigger,

excessive cash severance multiples, or an excise tax gross-up. These provisions may serve as a quasi-incentive to do a deal, and would not serve shareholders or stand up to governance standards.

If necessary, it is perfectly appropriate to make amendments to existing severance arrangements for these temporary base salary reductions. However, any changes should focus on the clarification of certain provisions and definitions, and should still be considered within a context of good governance standards.

Archived copies of previous Energy Insights can be found at www.meridiancp.com/insights/energy.

To have your name removed from our Energy Insights email list, please contact jlawler@meridiancp.com.