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"[T]he Senior Vice President's decision was not entitled to deference because the agreements and plans granted discretionary authority only to the Executive Compensation Committee . . . ."

THE WRONG MAN FOR THE JOB

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It is important to have the right person make decisions. And in the executive compensation context, this means having decisions made by the parties empowered to do so under the relevant plan documents and agreements. A company recently learned that having the wrong party make decisions about executives' entitlement to performance share and restricted stock can cause a court to carefully examine any payment denials. And in the case at hand, the court concluded that the denials were wrong, awarding the executives the payments to which they claimed they were entitled.

The case is *Schaffart v. ONEOK, Inc.*, 686 F.3d 461 (8th Cir. 2012). In *Schaffart*, the Eighth Circuit Court of Appeals considered claims by a couple of former high-ranking executives in the company's Omaha, Nebraska office. The company and the executives had entered into written performance share and restricted stock agreements, pursuant to the company's long-term incentive plan (LTIP) and a separate equity compensation plan.

The agreements required the executives to continue to work for the company for a three-year performance period to receive the full number of shares awarded. Terminating employment before the end of the performance period would result in forfeiting the shares, unless the executives qualified for a pro rata payment. The performance share and restricted stock agreements each provided for pro rata payments in the case of retirement, and the restricted stock agreements also provided for pro rata payments if the executives were involuntarily terminated without cause. Unfortunately, the agreements did not define the terms "retirement" or "involuntary termination."

The company sold some of its assets and in connection with that sale closed its Omaha office. The buyer hired some of the company's former employees in Omaha, but did not offer employment to the executives in question. The company told those executives they had to move to Tulsa, Oklahoma, if they were to continue being employed by the company. The sale occurred in 2006, and by August 2006 one of the executives informed the company that personal obligations in Omaha prevented her from moving to Tulsa. Her last day of work was December 31, 2006. The other executive began commuting to Tulsa in the spring of 2006. But in February 2007, he told the company he could not continue commuting to Tulsa because his wife filed for divorce and initiated a custody dispute. His last day of work was April 27, 2007.

The question was whether the executives were entitled to pro rata payments under the equity agreements. The agreements expressly gave the Executive Compensation Committee of the company's board of directors authority to administer the plans. The plans specified that this compensation committee was to be composed of two or more non-employee directors. The plans gave the committee the "full power to interpret, administer, and construe" the plan and full authority to make determinations and decisions under the plan. The plans and agreements, consistent with this, provided that the committee's interpretations of the plans "shall be final, binding, and conclusive" on the company and all participants and beneficiaries.

The rub, though, from the company's perspective was that a senior vice president of the company, by himself, made the determination of whether the executives were entitled to pro rata payments. This individual was described by the court as a "Senior Vice President of Administrative Services and Authorized Representative and Fiduciary to the Benefit Plan Committee." He was not, however, a member of the Executive Compensation Committee that had the power to interpret the plan. The Executive Compensation Committee did not decide or review the executives' claims.

The Senior Vice President decided the executives were not entitled to pro rata payments, concluding that they had voluntarily left the company. That was because they had declined to transfer to Tulsa. The Senior Vice President also concluded that the executives had not retired, and in doing so looked for guidance on what "retirement" meant by looking to the company's separate retirement plans, which permitted some participants to retire as early as age 50. The executives were, however, ages 47 and 49, respectively. Notably, the company had under the same plan agreements paid some of its former employees who accepted employment with the buyer their pro rata shares under the plans, without any requirement that they be at least 50 years old.

The company argued that the court must accept its decision that the executives were not entitled to payments "absent evidence of fraud, bad faith, or a gross mistake in judgment" because the company had "full discretion and decision-making authority on all matters." The court rejected this argument, saying that the Senior Vice President's decision was not entitled to deference because the agreements and plans granted discretionary authority only to the Executive Compensation Committee, and that committee neither decided the claims nor delegated any authority to the Senior Vice President.

The two equity plans included choice of law provisions. One provided for the application of Delaware law and the other called for application of Oklahoma law. The court acknowledged that under Delaware law "when a stock option committee is vested with final binding and conclusive authority to determine a participant's right to receive or retain benefits, that decision made in accordance with the provisions of the agreements will not be second guessed by the Court absent a showing of fraud or bad faith." And the court said that although there was no Oklahoma law on point, Delaware's rule has been applied outside of Delaware.

But the court said this deference is due a decision only if it is made in accordance with the provisions of the agreement. And under the agreement, discretionary authority to administer the plans was given to the Executive Compensation Committee, not to the company, its board as a whole, the company's Benefits Plan Committee, or the Senior Vice President who decided the claims.

After rejecting the argument that the Senior Vice President's determination was entitled to deference, the court upheld the district court's judgments against the company and in favor of the executives, including its award of money damages. Adding to the pain, the Eighth Circuit ruled that the district court had made a mistake in denying the executives' requests for attorney's fees, and sent the case back to the district court to determine the amount of the attorney's fees to be awarded to the executives, suggesting that this should include their fees in connection with the appeal to the Eighth Circuit.

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Lesson. It is, of course, well accepted that it is important for an equity plan to be operated in accordance with its terms. This is true not only with respect to its substantive provisions, but also with respect to those involving procedure, such as who is to make decisions about executives' eligibility for payments. One can't be sure, but our hunch is that the company in *Schaffart* might have prevailed had its compensation committee made the determination that the executives were not entitled to pro rata payments.

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