

# Compensation Arrangement Considerations in Light of 2025 Tariffs

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As explained in this March 12 Cooley alert, the impact of the Trump administration's evolving tariff regime will be felt by US companies across the board. Many will encounter rising material costs and reduced profit margins, particularly given the significant pressure on the supply chain. Taken together with the recent stock market volatility, companies (both public and private) will need to address the impact of these challenges on their business and, importantly, consider the effects on director and executive compensation programs.

In some respects, these compensation issues and considerations seem likely to echo those raised several years ago by the coronavirus pandemic – for example, the frequently changing landscape and lack of precedent – and companies will be well served to remember the lessons learned then. Companies should be thinking about what they can or should be doing to ensure the ongoing effectiveness of their equity incentive and other compensation plans, as they did in 2020 and the years immediately following. Particularly important considerations include the continued appropriateness of specific performance goals, the effect of stock price volatility on equity incentives, the size of available equity plan share reserves (including any automatic equity grants) and the availability of cash versus equity to fuel the company's compensation programs.

### General/overall program considerations

Treatment of currently active compensation programs will be different from planning for programs that have not yet been established.

For programs with performance periods that are already underway, the only remaining practical lever is using legally/contractually available discretion to adjust the amounts payable. If the performance metrics already feature built-in flexibility that can fairly accommodate adjustments based on the tariff developments and/or stock volatility being unforeseeable or unforeseen events, adjustment can be made with less complexity.

Where a program is still being designed, multiple levers exist as part of a toolbox that has been available, used and refined since the COVID-19 days. While post-performance, pre-payment discretion is part of that toolbox, extensive reliance on discretion will be viewed negatively if stakeholders conclude that more nimble management and better foresight could have blunted the impact of tariffs.

Decision-makers must remain focused on providing properly calibrated incentives with appropriate performance metrics and reasonable assessment of management's performance against those metrics, taking tariff and volatility impacts into account, among all other relevant factors. This focus needs to be led by the company, board and/or compensation committee as applicable. Given the overall macroeconomic and sociopolitical climate, there is a strong risk that any accommodation for those impacts will be viewed as unduly rewarding executives, particularly if rank-and-file employees do not benefit in a proportionate way; accordingly, compensation committees and boards must tread deliberately and carefully.

It is critical that the board and/or compensation committee and management engage in robust discussion about the changing landscape and factors at play. That engagement likely will be needed on a "one thing at a time as it happens" basis as circumstances evolve, especially if the tariff landscape continues to change as rapidly and dramatically as has been the case so far. An additional piece of the calculus that the board and management will have to consider is the fact that tariff effects will likely vary widely from industry to industry – and perhaps even from company to company within a given industry.

### Specific potential action items

Here are some key considerations for compensation programs in light of the current actual and potential new tariffs.

### 1. Ensure that there is company discretion to determine whether corporate or individual performance targets are met

Companies that are in the process of establishing incentive compensation performance metrics should be sure to take new tariff consequences into account and, in any event, companies may need to rely on, or build in more, discretion within their bonus plans or performance-based equity awards to give them flexibility to address the impact of the tariffs on the company's business, the financial markets and the economy. Companies should involve their accounting advisors when considering adding flexibility to arrangements in order to avoid inadvertently creating adverse accounting consequences. It's likely that stockholders and proxy advisors will react to the use of discretion in manners similar to those that evolved over the course of the coronavirus pandemic. For public companies, clear disclosure of payment decisions will be critical, and the rationale for and timing of any adjustments will be closely scrutinized. Consider the optics of the potential disclosure before decisions are implemented to prevent later headaches.

#### 2. Consider using stock price averages to determine the number of shares subject to incentive equity awards.

The impact of recent stock price fluctuations and market volatility can be reduced by using a trailing average stock price when determining the economic value of the number of shares subject to an equity incentive award. For public companies, because the value shown for an award in the executive compensation table pursuant to Securities and Exchange Commission (SEC) rules may differ from the award value communicated to executives based on the trailing average price, expectations and sensitivities may need to be managed.

#### 3. Assess adequacy of share reserves.

Companies should confirm the number of shares available under their equity incentive compensation plans, including employee stock purchase plans (ESPPs), to ensure that sufficient shares remain available for purchase, particularly if there has been a steep drop in price since the share pool was last assessed (or, in the case of an ESPP, since the commencement of the current offering period). Similarly, if there are individual or aggregate award limits under a plan based on share number, those may need to be revisited to ensure that they continue to provide adequate headroom.

#### 4. Preserve company cash if appropriate.

Market uncertainty can often strain a company's cash resources, or at least reinforce the need for prudent cash flow management. Companies should consider whether they have the flexibility to settle awards in equity rather than cash, mindful that doing so can trigger significant securities law, accounting and disclosure consequences. In addition, companies should work with equity plan administrators to evaluate the availability of net settlement for exercise price payment or tax withholding purposes, and perhaps consider limiting the availability of at least net exercise price payment to only individuals subject to Section 16 reporting requirements.

#### 5. Consider whether recent events have impacted the company's 409A valuation.

Private companies should consider whether to rely on a 409A valuation issued within the past 12 months and before the recent tariff developments, or to stop granting new stock options until the company obtains a new 409A valuation that takes into account the potential impact of the tariffs and market volatility on the company's valuation. If the situation is rapidly changing, it may make sense for the company to briefly pause new stock option grants and obtain a new 409A valuation once there's more clarity around the economic impact of the tariffs and volatility. Of course, additional valuations might be required in the future if the unfolding situation makes continued reliance on an existing valuation unreasonable. Companies should keep in mind that until a new 409A valuation is obtained, options must be granted with an exercise price at least equal to the current 409A valuation in order to comply with the safe harbor under Section 409A of the Internal Revenue Code, even if the stock value has likely dropped in the interim.

#### 6. Avoid or address underwater stock options.

If the company is concerned about a falling stock price, granting full value awards (e.g., restricted stock units) instead of stock options will avoid underwater options (i.e., options with exercise prices above the current market

value). Going forward, companies with options that are likely to be considerably underwater for a prolonged period of time may need to consider implementing a repricing program or an exchange program to address the lost retention and incentive value of such options. While stock option repricing and exchange programs can be powerful tools in the context of a prolonged market downturn, they should be carefully considered before implementation.

#### 7. Review ESPP documents.

ESPP documents often contain provisions that either automatically or at the discretion of the plan administrator will cancel an offering period and start a new offering period if the stock price on the purchase date is lower than the stock price on the offering period commencement date. ESPP documents should be reviewed to determine whether they contain an automatic or permissive restart feature. Companies with plans that do not currently utilize an automatic or permissive restart feature should consider whether to include such a feature in future offerings to preserve shares.

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