[Using 'Clawback' to Take Back Ill-Gained Bonuses]

written by Rory Lodge | October 9, 2015

The revelation that Volkswagen rigged diesel vehicles to pass emissions test is expected to cost the company tens of billions in recalls, repairs, fines and lost brand value. Particularly irksome is the fact that last year former VW CEO Martin Winterkorn, the man behind the scandal (although he denies any personal wrongdoing), made €15.9 million ($17.8 million (US)), including huge bonuses.   Were it inclined to try, *could* VW get back at least some of that bonus money from Mr. Winterkorn? The question affects not just VW but any company that pays incentive bonuses to executives later found to have engaged in wrongdoing.

The Right of Clawback

Arrangements in which employees forfeit previously paid incentive compensation as a result of wrongdoing (referred to as "clawbacks") are mandatory under U.S. law in limited situations. For example, Sarbanes-Oxley (aka SOX) requires CEOs and CFOs of public companies to repay bonuses based on financial statements that turn out to be inflated or illusory.

In Canada, there is no law mandating clawback. But while not specifically required, Canadian companies *are allowed* to make clawback arrangements with their employees. And leading investment and corporate governance institutions like the Canadian Coalition for Good Governance (CCGG) have recommended clawback as a best practice.

How to Make a Clawback Arrangement

Although still fairly rare, clawbacks have become more popular. If you want to make a clawback arrangement, you should effect it in writing before awards are paid. One approach is to add clawback provisions to the employment contract. Another option is to add clawback terms to grants of bonuses or other awards to which the clawback apply.

4 Things to Include in a Clawback Arrangement

There are at least four key issues to address when designing your clawback arrangement:

1. **Which Employees the Clawback Covers**

You should impose clawbacks only on the company’s most senior executives and other employees who are in a position to affect the awarding and/or amount of the particular bonus or incentive award covered.

2. **What Triggers the Clawback**

Specify what has to happen for the company to exercise clawback rights. Common triggers:

- Bad faith, including for a defined period after leaving the company, such as violating the noncompete;
- Fraud, negligence or intentional misconduct resulting in revision of the financial results on which the bonus or award is based; and/or
- Any restatement of financial results, regardless of fault.

3. **Which Compensation the Clawback Covers**

Clawback should apply to the incentive payments employees receive as a result of their wrongdoing. This typically includes both annual and long-term cash and equity-based bonuses and awards.

4. **When the Clawback Expires**

Clawback is often limited to a specific time or “look-back” period, typically two to three years. Once the look-back expires, the employee is off the hook regardless of what revelations come to light later.