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Agenda

- Compensating Employees through Digital Assets
- Equity Compensation
  - Purposes of Equity Compensation
- FinTech Employment Issues
  - Worker Classification
  - Remote Work Considerations
  - Managing a National (and International) Workforce
  - Documenting the Employment Relationship
- Equity Compensation
  - Types of Equity Compensation
- Key Employment Trends
  - Restrictive Covenant Agreements Under Fire
  - Paid Sick Leave Requirements
  - Labor Law Developments

Compensating Employees Through Digital Assets

- Why the demand?
  - ***Recruiting/Retention –*** Competition for talent in a market where employees expect/demand crypto as compensation
  - ***Industry*** – Company is in the FinTech space
  - ***Image*** – Companies want to appear cutting-edge, employees want to work for forward-thinking company
  - ***Reward*** – Hopes for big gains

Compensating Employees Through Digital Assets

- The Fair Labor Standards Act (the "FLSA") likely prohibits companies from paying employees' base compensation, *i.e.,* wages, with digital assets.
  - Digital assets are not "cash or negotiable instruments" as required under the FLSA.
  - **§ 531.27 Payment in cash or its equivalent required**
  - Standing alone, sections 6 and 7 of the Act require payments of the prescribed wages, including overtime compensation, ***in cash or negotiable instrument payable at par***.
- In a May 2006 Opinion Letter, the DOL interpreted "negotiable instrument payable at par"
  - Authorized payments to employees with foreign currency to satisfy minimum salary requirements for exempt employees
  - Permitted when currency met the FLSA threshold after being exchanged into USD using "exchange rate current at the time of payment (*i.e.,* the rate generally available to an individual person in the vicinity where the employee was working).
- DOL has not determined whether cryptocurrency constitutes a "negotiable instrument payable at par."

Compensating Employees Through Digital Assets

- Many state laws are more rigorous than FLSA requirements. For example…
- **Method of Payment**
  - California – requirement that any non-cash payment must identify where the recipient can redeem the instrument received. (*Cal. Labor Code § 212*)
  - Florida – employers who issue alternative payments are liable for the value of the payment in U.S. currency. (*Fl. Code 2005 Ch. 532.02*)
  - Illinois – "wages and final compensation shall be paid in lawful money of the United States." (*820 ILCS 115/4*)
  - Pennsylvania – "wages shall be paid in lawful money of the United States or check." (*43 P.S. Labor § 260.3*)

Compensating Employees Through Digital Assets

- Depending on a worker's location, requirements can be variably onerous for compliance with pay stub, wage notice, or pay period laws – employers must be separately equipped and certain that their payroll teams can handle this.
  - California: detailed payroll requirements; violations subject to PAGA claims
  - Colorado: pay statements must include gross and net wages earned
  - Connecticut: weekly paychecks required unless otherwise approved by the labor commissioner
  - Washington State, New York, Virginia: basis of pay and rate of pay listing required on pay stubs, and any deductions
  - Georgia: Twice a month, no paystub requirements
- Employers using payroll vendors or automated software may be unable to properly meet these requirements based on availability of certain digital assets, including delivery to employee's digital wallets, or other calculations like gross and net wages based on fluctuating value of applicable assets or tokens.

Payment in Company Currency - Scrip Laws

- Companies that issue their own tokens or other digital assets/currency may not pay employees in that currency as a substitute for wages.
- Federal and other state laws prohibit payment in company "scrip," or other company issued coupons or credit cards. (*See* **29 CFR § 531.34 - Payment in scrip of similar medium not authorized.).**
- Compensation paid with limited avenues for redemption may be equivalent to the forcing employees to shop at the "company store."
- Employers looking to equate these kinds of payments under an options or incentive gamification model should tread carefully and assess this on a case-by-case basis.
- 29 C.F.R. § 531.34 – Payment in scrip or similar medium not authorized.

Crypto Bonuses - Risk Factors

- Volatility
  - Employees may rely on expected bonuses and be shocked when a market swing or currency failure leaves them with far less than anticipated
- Taxes
  - Employees who realize an opposite result may suddenly face a tax burden they are not prepared or equipped to handle.
  - How assets are characterized affects this.
  - Employers should also pay close attention to reporting requirements to understand how payment through potentially volatile assets may affect their own obligations.
- Shifting and Variable Regulations
  - Do not forget that wage laws like pay stub requirements, among others, apply in many jurisdictions to bonuses as well.
  - Incentive pay via alternative currencies could affect any number of other topics we've discussed so far.

Crypto Bonuses - Risk Avoidance

- **Exception and Not the Rule**
  - Employers should consider making incentive pay through digital assets available only where employees request the option.
  - Employers should not force employees to accept this kind of bonus, particularly if pre-existing polices affect or create an expectation of additional compensation.
- **Put Risks in Writing…Put Everything in Writing**
  - Employees who request or opt to receive incentive pay, bonuses, or other non-wage compensation through digital assets should sign and acknowledge that they understand the risks inherent to this kind of compensation, including volatility and tax issues like earlier slides discussed.
  - Employers should work with legal advisors to make sure those risks and any related laws or regulations are clear and easy to understand.

Equity Compensation

- **Purposes of Equity Compensation**
  - Incentivize service provider performance over the long-term and short-term
  - Align the interests of the company's service providers with those of its shareholders.
  - Improve service provider productivity, resulting in increased company value.
  - Attract and retain valuable service providers
  - Payout cash, shares, or a combination of the two
  - Deliver tax-deferred growth benefits when properly designed.

Equity Incentives – General Terms

- **General Terms**
  - Equity Compensation Incentives should be delivered pursuant to a written plan document and written award agreement specifying the material terms of such awards:
  - Vesting
  - Time-Based Vesting
  - Performance-Based Vesting
  - Forfeiture upon Termination of Employment
  - Change in Control
  - Share Reserves
  - Adjustments of Awards

Types of Incentives

- **Types of Equity Compensation Incentives**
  - Incentive Stock Options
  - Non-Qualified Stock Options
  - Restricted Stock
  - Restricted Stock Units
  - Stock Appreciation Rights
  - Phantom Stock
  - Performance Shares
  - Performance Units

Worker Classification

- Exempt vs. Non-Exempt Employees
  - Under federal law, employees must receive a minimum of $684/week, or $35,568 annually if classified as exempt from overtime and minimum wage requirements. (FLSA Section 13.1 / 29 U.S. Code § 213)
  - To qualify for the highly compensated employee exemption, employees must be paid total annual compensation of $107,432 or more.
- Due to dramatic fluctuations in digital asset values, employers risk liability and penalties for wage violations and misclassifications if the value decreases below federal minimums in a given pay period.
- Ensuring compliance imposes additional administrative burdens on employers.

Worker Classification

- Employees vs. Independent Contractors
  - Workers are not independent contractors unless they meet criteria that varies largely between states, and, at minimum, include operational control over their work and equipment, evidence that the worker runs their own business, and other factors like control over their schedule.
  - **RECOMMENDATION**: Seek legal advice for any questions involving independent contractor classification before you enter into the relationship. This analysis **must** be performed on a case-by-case basis.
- Penalties for Misclassifying employees include:
  - IRS fines
    - Payment of FICA taxes and income tax withholdings
    - IRS Penalties for Inaccurate W-2 Forms
    - Additional Penalties
  - DOL Audits and Penalties
  - Class Action Lawsuits
  - Wage Claim Audits
  - Worker's Compensation Penalties
  - Employee Benefits Liability

Worker Classification

- Proper classification requires a nuanced analysis of several factors, which vary by state, including:
  - Presence of a written contractor agreement
  - Degree of control over relationship
  - Level of instruction
  - Company training
  - Integration of services into business operations
  - Whether services are required to be performed personally
  - Authority to hire and supervise assistants
  - Length of relationship
  - Set work hours
  - Whether full time services are required
  - Location where services are provided
  - Reporting requirements
  - Rate of pay
  - Payment of business and travel expenses
  - Furnishing tools and materials
  - Right to discharge
  - Worker's right to terminate
  - Investment in trade
  - Realization of profit or loss
  - Ability to work for more than one company at a time
- **CAUTION:** Many states consider additional factors for worker classification

State (and local) Wage Laws: Independent Contractors

- **ABC Test (California, Illinois, Georgia…)**
  - The worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact;
  - The worker performs work that is outside the usual course of the hiring entity's business; and
  - The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.
- **Common Law Test (New York, Texas, South Carolina…)**
  - Behavioral control: Employer controls how workers perform work.
  - Financial control: employers pay compensation and other expenses.
  - Type of relationship: What do the contracts say? What are the terms of employment.

Remote Work Considerations

- Written Remote Work Policies and Procedures
- Wage and Hour Considerations
- Monitoring Employee Workload and Production
- IT Security and Confidentiality
- Reimbursing Employees for Remote Working Expenses

Managing a National (and International) Workforce

- Employers must comply with all applicable laws in the jurisdictions they operate
  - National
    - Wage and Hour Laws
    - Enforceability of Restrictive Covenants
    - Applicable Leave Laws
    - Drug Testing
    - Registering to do Business
    - Revisions to Employment Documents
  - International
    - Immigration
    - Changes to Presumption of Employment at Will
    - Mandatory Severance
    - Formation of International Entities
    - Revisions to Employment Documents
- **SEEK COMPETENT COUNSEL BEFORE HIRING EMPLOYEES IN OTHER STATES OR COUNTRIES**

Documenting the Employment Relationship

- It is vital that FinTech Employers have appropriate documentation for the employment relationship
  - Recycled employment documents put your company at risk
  - Need to take into account state law and issues specific to individual employees
  - Chat GPT is not sufficient
- Key employment documents:
  - Job Postings
  - Offer Letters
  - Background Check Authorizations
  - Employment Agreements
  - Independent contractor Agreements
  - Confidential Information/Invention Assignment Agreements
  - Equity Agreements
  - Employee Handbooks and Policies
  - Performance Evaluations
  - Disciplinary Forms
  - Severance Agreements

Types of Incentives – Stock Options

- **Stock Options**
  - A stock option gives the holder the right to buy a share of company stock at a specified price over a specified period of time.
  - A company may grant a fully vested stock option, but more typically an option is subject to either Time-Based or Performance-Based Vesting.
  - Some startup companies design their Stock Options to allow optionees to exercise unvested options and receive Restricted Stock that remains subject to the same vesting conditions and other terms that applied to the Stock Option (i.e., early exercise).

Types of Incentives – Incentive Stock Options

- **Incentive Stock Options**
  - Incentive Stock Options ("ISOs") are a type of Stock Option that satisfies the requirements of Section 422 of the Code.
  - ISOs may only be granted to employees (independent contractors, consultants, and entities are not eligible for ISOs).
  - ISOs must be exercisable by the optionee while they are an employee or no later than 3 months after termination of employment.
  - Exceptions:
  - If the optionee's employment is terminated due to disability, the exercisability period may extend to one year following termination.
  - In the event the optionee's employment is terminated due to death of the optionee, the optionee's estate may exercise the ISOs until the ISOs' expiration date.

Types of Incentives – Incentive Stock Options

- **Incentive Stock Options**
  - ISOs may only be granted pursuant to a written plan approved by the company's shareholders within 12 months before or after the plan's adoption.
  - The written plan must specify:
    - The number of shares that may be issued pursuant to ISOs; and
    - The employees or class of employees eligible to receive ISOs.
  - ISOs must be granted within 10 years of the plan's adoption or approval by the shareholders, whichever is later.
  - ISOs must be exercisable only within 10 years of the date of grant (except with respect to ISOs awarded to individuals who own more than 10% of all outstanding company stock, in which case the exercisability period may not extend more than 5 years following the date of grant.

Types of Incentives – Incentive Stock Options

- **Incentive Stock Options**
  - ISOs must be granted with an exercise price no less than 100% of the FMV of an underlying share on the date of grant (except for ISOs awarded to individuals who own more than 10% of all outstanding stock of the company, in which case the exercise price must be no less than 110% of the FMV of an underlying share on the date of grant.
  - The optionee holding ISOs may not transfer the ISOs other than by will or by the laws of descent and distribution.
  - The ISOs must be exercisable only by the holder during the optionee's lifetime.
  - The aggregate FMV (determined on the ISO's grant date) of shares purchased through the exercise of ISOs that exercisable for the first time in any calendar year cannot exceed $100,000.

Types of Incentives – Non-Qualified Stock Options

- **Non-Qualified Stock Options**
  - A Non-Qualified Stock Option (an “NQSO”) is an option that does not qualify as an ISO under Code Section 422.
  - NQSOs are more flexible than ISOs. A company may issue NQSOs to employees, directors, independent contractors, and consultants.
  - Generally, NQSOs are granted with an exercise price of no less than 100% of the FMV of an underlying share.
  - However, an NQSO may be granted with an exercise price below 100% of FMV if the option complies with 409A.

Types of Incentives – Restricted Stock

- **Restricted Stock**
  - Shares of Restricted Stock are actual shares of the company's common stock that carry restrictions on transfer, sale, or other disposition of the shares over a specified period or upon the achievement of specified vesting conditions.
  - "Vesting" means that the service provider has a non-forfeitable right to the stock.
  - A company can award shares of restricted stock outright, or it can require the award recipient pay a purchase price for the shares.
  - Typically, because shares of Restricted Stock are considered actually issued upon grant, the holders of restricted stock generally have the same or similar dividend rights and voting rights as other shareholders.
  - Restricted Stock is generally not taxed on grant.
  - Instead, the award recipient will recognize taxable income when the shares no longer fact a substantial risk of forfeiture (i.e., vesting).

Types of Incentives – Restricted Stock Units

- **Restricted Stock Units**
  - A restricted stock unit (an “RSU”) represents the right to receive an amount equivalent in value to a single share of stock (which can be settled (paid) in cash, actual shares, or a combination thereof) on a future date.
  - Subject to Time-Based or Performance-Based Vesting.
  - Because RSU represent the right to receive shares, not actual shares, RSUs do not carry voting or dividend rights.
  - However, an RSU award can be structured to provided “dividend equivalents.”

Types of Incentives – Stock Appreciation Rights

- **Stock Appreciation Rights**
  - A Stock Appreciation Right (a “SAR”) gives the holder the right to receive the excess of the FMV of an underlying share of stock over the exercise price of the SAR.
  - Conceptually, SARs are very similar to Stock Options, except that no actual purchase of shares occurs in the exercise of a SAR and the company may settle the value of a SAR in cash, shares, or a combination of the two.

Types of Incentives – Other Stock Incentives

- **Other Stock Incentives**
  - Phantom Equity – A Phantom Equity award is expressed as an award of hypothetical (“phantom”) shares but is actually simply a promise to pay cash based on the value of the company’s stock.
  - Performance Shares – An award of Performance Shares is typically expressed as a target number of shares that the company will issue to the participant based upon the achievement of specified performance metrics.
  - Performance Units – A Performance Unit is conceptually identical to a Performance Share, except that the Performance Unit has a designated dollar value that, if vested, can be paid out in cash, shares, or a combination of the two.

Trends - Restrictive Covenants Under Fire

- The law surrounding Restrictive Covenant Agreements (Non-Competition and Non-Solicitation Agreements) is in a state of massive flux
- These provisions are more common for FinTech employers, who are on the cutting edge of technological development
- FTC Ban
  - Bans most existing and future non-competition agreements
  - Exceptions are very nuanced and limited in scope – consult with counsel
  - Final Rule issued April 23, 2024, banning noncompete clauses nationwide
  - Scheduled to take effect 120 days later (August 21, 2024)
  - Differentiates between Senior Executives (earning more than $151,164 annually and in position with authority to make policy decisions that control significant aspects of the business) and other employees
  - Applies to independent contractors
- Key Trends in State Laws
  - General Prohibition (CA, ND, OK, MN)
  - Salary Restrictions (CO, DC, IL, ME, MD, OR, RI, VA, WA)
  - Forum Selection Clause and Choice of Law Clause Limitations (CA, CO, MA, WA)
  - Payment During Restricted Period (MA, OR)
  - Written Notice Requirements (CO, OR)
  - Limitations on Time, Geographic Scope, and Range of Activities Prohibited
- **Note – This list is not exclusive and state laws are changing rapidly. Consult counsel to discuss the laws governing restrictive covenants in the jurisdictions that you operate.**

Trends - Restrictive Covenants Under Fire

- **Recommendations**
  - Consult with counsel before the effective date (currently August 21, 2024) and prior to taking any action
    - Several pending legal actions challenge the Final Rule
  - Be prepared to enact changes to employment agreements, confidentiality agreements, non-competition agreements, employment policies, and employee handbooks
  - Work with counsel to prepare notice to employees as required by the FTC Rule
  - Draft any future restrictive covenants under the guidance of counsel
  - Don’t ignore state law
    - Conduct a state-by-state and employee-by-employee assessment before entering into restrictive covenants
    - Even if the legal challenges to the FTC ban limit the scope of the rules, state restrictions will still apply
    - State restrictions may also govern non-solicitation provisions
    - Focus on changing state laws
      - Salary restrictions
      - Notice requirements
  - Require incoming employees to disclose all restrictive covenants

Trends - Paid Sick Leave Requirements

- Not federally mandated
- FMLA allows eligible employees to take up to 12 weeks of unpaid leave for certain qualifying reasons
- Seventeen states have enacted paid sick leave laws
- Vary widely by state
    - Accrual
    - Qualifying reasons
    - Required documentation
    - Payment on termination
- May include maternity leave and domestic violence victims leave obligations
- Recommendations
    - Establish written policies to identify Company standards for paid sick leave
    - Update handbooks and offer letters as required by applicable state law
    - Monitor applicable laws in the jurisdiction(s) you operate

Trends - Labor Law Developments

- Recent Increase of Union Activity
  - More petitions for union representation filed
  - More unfair labor practice charges filed
  - High profile strikes
  - NLRB GC Memos defining enforcement priorities and interpretation policies
- Expanded union activity in traditionally non-unionized sectors
- Understand how the National Labor Relations Act applies to non-unionized employees
- Review employment handbooks and policies for compliance with Section 7 of the NLRA

Contact Details

To learn more about our FinTech and Regulation practice, or to contact a member of our team, click here or visit our website at nelsonmullins.com.

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Presenter Biographies

CHRISTOPHER J. EBY

Chris focuses on employment litigation and counseling. He has represented employers before federal and state courts and agencies in a variety of employment matters, including Title VII discrimination and harassment claims, wage and hour class and collective actions, claims brought under the Americans with Disabilities Act and Family and Medical Leave Act, and noncompete and trade secret enforcement. In addition, he advises clients on employment issues, including policy interpretations, compliance issues, employee discipline, and employee termination. Chris also assists employers in drafting policies, handbooks, and employment agreements.

MATTHEW R. ZISCHKE

Matt Zischke has experience advising all types of employers on a variety of benefits matters, including design, implementation, and administration of employee benefit plans such as defined benefit, defined contribution (e.g. 401(k) and 403(b)), equity incentive, deferred compensation, and health and welfare arrangements. Matt's experience includes SIMPLE IRA, ESOP, cafeteria, wrap, HRAs, HSAs, and severance plans.

Moderator Biography

RICHARD B. LEVIN

Richard is chair of the FinTech and Regulation Practice and was one of the first lawyers to focus on the regulation of blockchain and digital assets. He is considered a thought leader in the FinTech space. Richard brings his experience as a senior legal and compliance officer on Wall Street and in London to bear in advising clients on corporate, FinTech, securities, and regulatory issues. A problem-solver by nature, he has been advising FinTech clients on legal and regulatory issues since the start of electronic trading in the late 1990s. His practice focuses on helping financial services and technology clients identify and address regulatory issues as they build their businesses.

Richard's practice focuses on the representation of early stage and publicly traded companies in the FinTech space, including investment banks, broker-dealers, investment advisers, peer-to-peer lending platforms, digital currency trading platforms, alternative trading systems (ATSs), exchanges, and custodians. He represents these firms before the U.S. Securities and Exchange Commission (SEC), the U.S. Commodity Futures Trading Commission (CFTC), the Financial Industry Regulatory Authority (FINRA), the U.S. Department of the Treasury, Office of the Comptroller of the Currency (OCC), state regulators, and Congress. Richard has represented clients before regulators in Australia, Canada, France, Germany, Hong Kong, Ireland, Japan, Singapore, South Korea, and the United Kingdom. His current and past clients include leading national financial institutions, multinational financial services holding companies, leading firms in the FinTech space, and institutions engaging in global investment banking, investment management, securities, and other financial services with institutional clients.

Richard has been identified by Chambers and Partners as one of the leading lawyers in the Blockchain and Cryptocurrencies category since the inception of the category. He has been recognized by Chambers for his knowledge on regulatory matters, great relationships with regulators, for helping clients push the boundaries of the FinTech sector, and for his advice on matters such as broker-dealer licensing and alternative trading systems. Richard is routinely quoted by leading publications including Bloomberg, the New York Times, Reuters, and the Wall Street Journal and is a frequent speaker at conferences around the world on the regulation of FinTech, blockchain, and digital assets.