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# Executive Employment Agreements



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# Why Have an Agreement?

- More for employee than employer
  - Employer can use offer letters, targeted agreements (covenants, arbitration) and unilateral plans/policies/handbooks for greater flexibility
  - Employee prefers an individual agreement that provides enforceable contractual rights, and that can cover individualized benefits promised in negotiation
  - Primary drivers: Bargaining power of employee; common practice in company/industry/employment market; desire to document special benefits

# Term

- Three approaches
  - Fixed term; no renewal
  - Fixed term with periodic renewal (unless one of the parties gives notice)
  - Evergreen; contract continues until employment terminates
- Key: Think about what the purpose of the term is – do parties just walk away at expiration? At-will employment? Severance payable?

# Title/Duties/Reporting

- Has three principal purposes:
  - Gives the executive assurance regarding these issues; often very important to executive
  - May support a company termination for cause (for failure to perform enumerated duties)
  - May support an employee resignation for good reason (for material change in duties or reporting relationship)
    - Will discuss these two later
- Often includes restrictions on outside activities

# Place of Performance

- Can also be important to executive; may support resignation for good reason if relocated involuntarily
  - Executives may want flexibility – e.g., for some transition period, keep current residence, commute to HQ; company may require relocation after one or two years
  - Agreement can also provide for relocation benefits – perhaps subject to claw-back if leave before specified date (watch for tax issues)

# Compensation and Benefits

- Base salary – typically subject to annual review; may be stated as a “ratchet” (can go up but not down)
- Bonus opportunity – may be specific, or refer to executive bonus program (but specify target/minimum and maximum)
- Benefits and fringes – typically by reference to what similar executives get
- Any special benefits (vacation; sign-on bonus; hire equity grant; special fringes)

# Dispute Resolution

- Litigation vs. arbitration: Pros and cons
  - May include multi-step ADR, though query why needed
  - Carve-out for covenant enforcement
- Choice of law: Default to company HQ (or Delaware) vs. conscious choice (for benefit of employer or employee)
- Jurisdiction/venue: Company usually wants to limit to local courts
- Jury trial waiver (company preference)

# Dispute Resolution

- Attorneys' fees: May provide for fee-shifting in a dispute
  - Employer would prefer no provision, or at least equal opportunity to collect fees if it prevails
  - Employee wants a one-way provision (employer can afford to pay its lawyers)
  - Careful that employee pay provision does not apply to all disputes, even if employer prevails
- May include allowance for reimbursement of fees for negotiating agreement itself (usually capped)



# Termination Provisions

## ➤ Key defined terms

- Cause: Objective vs. subjective; employee right to due process; include or exclude performance issues
- Good Reason: Usually conforms to 409A definition
- Change in Control: Typically consistent with other definitions (equity plan)

# Termination Provisions

## ➤ Severance

- Accrued amounts always payable
- Salary continuation – period; form of payment
- Pro-rated bonus for year of termination; 162(m) issue for public company
- Bonuses for severance period
- Continued benefits (health); equity vesting; outplacement

# Termination Provisions

## ➤ Release/waiver

- Attach form vs. “form specified by company”
- OWBPA compliance (21 days to consider; 7 days to revoke)
- Special CA language
- Careful re: 409A issue – consideration/revocation spans two tax years; must specify that payment will be made in year two whenever signed (only applicable to 409A deferred compensation)

# Restrictive Covenants

- Best time to obtain: At hire/condition of hire
  - Covenants agreement signed later may not be enforceable (lack of consideration)
- Non-compete
  - Length; geographic scope; description of restricted business
    - Better if narrow; court may or may not blue pencil
  - Include bold CA disclaimer language if any chance employee will end up there
- Non-solicitation (customers/employees)
  - Should limit in CA to use of trade secrets/confidential info for customers

# Restrictive Covenants

- Confidentiality/trade secrets
- Assignment of inventions (not usually a big deal for executives, other than at smaller technology businesses)
- Enforcement (injunctive relief; employee agrees that damages not adequate remedy)

# Tax Issues

- Traps for the unwary on both sides, but especially representing employees
  - Don't assume that the employer's counsel is taking care of it
  - Consult with a tax lawyer
  - Agreement language re: tax issues – employer will generally disclaim any notion that it has given employee any tax advice; may disclaim any liability for adverse tax consequences
  - Agreement should always specify that all payments under the agreement are subject to withholding as required (i.e., amounts stated are gross amounts)

# Tax Issues

- Biggest issue: 409A compliance
  - Detailed and complex – beyond the scope of this presentation
  - Key: It's primarily the employee's problem (accelerated taxation, 20% added tax, penalty interest) – so employee and his counsel must be careful
  - Make sure that boilerplate is added to all employment agreements
    - Include 6-month delay for specified employees, even if private; company could go public or be acquired by a public company
    - Define key terms (e.g., separation from service)
    - SPECIFY THAT EACH PAYMENT IS SEPARATE FROM ALL OTHERS – can allow much greater flexibility in severance pay

# Tax Issues

- 280G: Golden Parachutes
  - Four basic approaches
    - Let chips fall where they may (equally bad for both)
    - Cutback (great for employer; may be good for employee or not, depending on size of payout)
    - Better of (better than preceding for employee, not as good for employer as cutback)
    - Gross up (or modified gross-up): Best for employee, but rapidly going away; too expensive for company



# Questions?