

Verrill

EXECUTIVE DECISIONS

Putting in Place Effective Employment Agreements
for Company Executives

Wednesday, March 4, 2020



Doug Currier
Partner, Verrill

dcurrier@verrill-law.com



Scott Connolly
Partner, Verrill

sconnolly@verrill-law.com

Agenda

- New Hire Negotiations: format & process, term sheets, offer “letters” vs. contracts
- Important terms/provisions for exec. employment agreements
- Restrictive agreements:
 - non-competes, non-solicits, NDAs
- Separation/settlement agreements and legal releases:
 - one size does not fit all situations

New Hire Negotiations: format & process -- Offer Letters vs. formal contracts

- Offer letters can be used for c-level executives, but more fulsome contracts usually expected
- At-will vs. term of years with early termination provisions and complex compensation provisions
- Form of initial contract negotiations: straight to offer letter or contract, but sometimes “non-binding” term sheet
- Provide related and referenced documents: benefits and plans, stock options and equity, early notice of non-competes

Offer letters vs. Employment Contracts

- Offer letters are more simple, but can be, and often are, used for executives instead of more traditional contracts
 - Offer letters strike a less formal tone, business-friendly
 - “I am pleased to confirm our offer of employment to join ABC. Inc. in the position of COO”
 - However, top executives may expect more formal agreement
 - “WHEREAS, the Company desires to employ Executive”
 - Same terms and conditions may be covered, but tendency is for offer letters to be used for at-will relationships without complex compensation, equity, and termination provisions.
 - Inconsistencies between offer letter and subsequent employment agreement

Treat Negotiations Thoughtfully: It's the start of a key relationship

- Employers desiring to attract and close top executive talent should anticipate the executive's reaction to “boilerplate,” legalese, and forms of agreement that are not tailored to the specific hire
- Providing fair, middle of road initial draft can positively affect process and relationship (and vice versa), i.e.: “get to yes!”
- Ensure that drafter, whether in-house or outside counsel, understands the situation and agreed-upon terms
- Whether in the open or not, executive likely is receiving attorney's advice
- Deal fatigue and how to avoid it
- Concerns about precedent

Key Terms & Provisions for Executive Employment Agreements

- Initial term and renewal provisions
- Job duties, location, and reporting relationship
- Compensation & benefits
- Equity & stock option grants
- Termination provisions, key definitions, and severance benefits
- Change-in-control provisions
- Choice of law and jurisdiction
- Dispute Resolution

Initial Term and Renewal Provisions

- Typically, a term of years is set, e.g. 3 years, that is subject to early termination provisions, e.g. for “Cause” by Company, for “Good Reason” by Executive, which terms are defined later in the agreement
- Automatic renewal absent advance notice, i.e. “evergreen” provisions, notice of non-renewal
- N.B.: does notice of non-renewal by Company act as severance pay trigger?

Job Duties, Location, and Reporting Relationship

- Full-business time and attention to duties; other duties and responsibilities assigned by Board/CEO “consistent with” executive’s position
- Reasonable carve-outs for other activities that do not compete/interfere: board of director positions for non-competitive companies
- N.B: job duties, title, reporting relationship, and location: can be tied to termination by executive for good reason
- Board member and service to affiliates; automatic resignation provisions

Compensation & Benefits

- Base salary: annual adjustment? subject to decrease? “Good Reason” trigger?
- Fringe benefits: enrollment, premiums and contributions
- Sign bonuses and claw-back provisions
- Annual bonuses/incentive compensation: careful with tax considerations
- Commissions for sales executives: N.B.: payment at termination disputes are common; can be subject to treatment as “earned wages.”

Compensation & Benefits

- Annual bonuses/incentive compensation
 - Target can be specified as a percentage of base salary
 - Discretionary vs. non-discretionary; objective metrics vs. subjective determination of Board or Compensation Committee
 - Achievement of objectives established by the Board and the executive? When set?
 - Termination prior to earning or payment: must be employed through the end of the calendar year and still be employed by the Company at the time it makes bonus payments to employees for that year?

Compensation & Benefits

- Sign bonuses and claw-back provisions
 - When paid?
 - Paid in installments?
 - Repayment circumstances?
 - Resignation? Resignation without Good Reason? Termination for Cause?
 - Repayment amount? Decrease over time?
 - Repayment timing?
 - Agreement to withhold / set-off from earned compensation at termination? Be careful.

Grants of Equity and Stock Options

- Subject to Company's plans and agreements; key terms and provisions usually set forth in employment agreement
- Vesting: When does clock start? Date of hire vs. date of Board's grant award?
- Acceleration of vesting at change in control is common issue
 - "double" vs. "single trigger"
- Long vs. short term incentives; forfeiture and repurchase
- "Phantom" stock alternatives

Early Termination and Key Definitions

- Executive employment agreements can be “at-will” or for a set initial term, but subject to early termination
- Consequence of various termination provisions is severance benefits, or not
 - Non-Renewal by Company or Executive
 - For “Cause” by Company
 - Without “Cause” by Company
 - For “Good Reason” by Executive
 - Voluntary resignation by Executive
 - Executive’s Death
 - Executive’s Disability

Definition of “Cause”

- Company-favorable definition may be broad and include subjective failure to meet performance expectations as determined by the Company
- Executive will favor narrow definition for egregious misconduct
- Notice and cure provisions? Is misconduct capable of cure?
- Common reasons:
 - Conviction of felony or other serious crime
 - Fraud or embezzlement
 - Breach of contract, such as restrictive covenants
 - Violation of important policies, e.g. sexual harassment
- Invocation of Cause for termination is rare
- Concepts of material harm and willfulness
- Who decides?

Definition of “Good Reason”

- Company-favorable definition may be NARROW and include notice and cure provisions
- Executive will favor more broad definition
- Common reasons:
 - Reducing title, job duties, authority, responsibilities, reporting relationship
 - Reducing Base Salary
 - Forced relocation
 - Company breach of contract
- If occurrence, when must executive notify? When must resign?

Severance Pay / Separation Benefits

- ALWAYS: conditioned upon executive's signing (and non-revocation of) a separation agreement that includes a release of legal claims in a form acceptable to the Company
- ALWAYS: conditioned upon continued compliance with restrictive covenants
- Lump sum vs. paid as salary continuation over time
- Handling bonus payments often an issue
- Commissions earned pre- but paid post-termination
- COBRA payments and health insurance continuation
- Subject to transition cooperation / cooperation in litigation

Dispute Resolution & Arbitration

- Perceived benefits of mediation and arbitration:
 - jury waiver
 - reduced time
 - lower costs and legal fees
 - limitation of class action claims
- Carve-out option for Company to seek court injunction for restrictive covenant breach
- Specify types of claims?
- Rules and procedures?
- Location and selection of arbitrator?
- Payment of fees and expenses?

Change in Control Provisions

- Single vs. double trigger: termination of employment in connection with a change in control
- Timing?
- Acceleration of vesting and severance benefits
- Types of Changes in Control:
 - A change in ownership such as a merger, consolidation or other reorganization
 - a sale, transfer or other disposition of all or substantially all of the Company's assets
- Cooperation with buyer

Choice of Law and Consent to Jurisdiction

- Will be of concern to executive if not state of residence/work location
- Perceived burden of pursuing or defending claims in distant forum; additional costs
- Drafting around employee protections?

Restrictive Covenants in Employment Agreements

- **Non-competition**
- **Non-solicitation**
- **Confidentiality and non-disclosure**

Employer's Perspective:

- Granting executive access to customer relationships and confidential and proprietary information
- Desire to protect legitimate business interests from unfair competition

Executive's Perspective:

- Will impede ability to seek new employment and make a living
- Restrictions often extend beyond severance pay continuation

State / Public Policy:

- Restrictions on free completion disfavored and subject to close scrutiny; only enforced if necessary and reasonable
- Concerns over unequal bargaining power

Non-Competition

- Review for compliance with state laws
- Must be necessary to protect legitimate business interest:
 - Intellectual property, trade secrets, confidential business information
 - Customer goodwill: the expectation of repeat sales/business with customers
- Must be reasonable
 - Duration
 - Geographic scope
 - Activities restricted
- During employment
- Preparation to compete

Non-Solicitation

- Existing customers
- Prospective customers
- Vendors
- Employees: anti-raiding
- Directly and indirectly
- What constitutes solicitation?

Confidentiality

- Define confidential information and tailor to business
- Unlimited as to time
- Third-party information
- Protection of data and documents
- Storage devices and remote work
- Return of property

Separation / Settlement Agreements and Releases of Claims: Key Points

- Lump sum vs. payment over time: stopping payment for misconduct
- The release must not be overbroad
- Claims that cannot be released
- Avoiding inadvertent releases of claims against the employee
- The subtle traps of Confidentiality restrictions
- The dangers of non-disparagement clauses
- What happens if there is a breach
- Preserving certain rights (e.g. restrictive covenants)
- Understanding ADEA and the Older Workers Benefit Protection Act
- Signing before separation and gaps in release coverage

Key Takeaways

- #1 Laws, especially state laws, are constantly changing so be wary of relying upon forms
- #2 Wage payment laws favor employees and provide severe penalties so compensation provisions must be well-drafted
- #3 Early termination provisions trigger severance payment obligations so be sure they work correctly to avoid surprises
- #4 Non-competes will be scrutinized closely, may not be enforced, and are subject to different state laws (illegal in CA), so ensure other restrictions offer adequate protection
- #5 A release of claims is not what it used to be, so careful drafting is required

Verrill

Values. Value. Valued.

Questions?

Thank you for joining!



Doug Currier
Partner, Verrill
dcurrier@verrill-law.com



Scott Connolly
Partner, Verrill
sconnolly@verrill-law.com

Disclaimer: These materials are intended for general educational purposes only and express our own personal views and are not to be construed as legal advice, or a legal opinion on any issue nor as the position of Verrill Dana, LLP or any of our clients.