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CEO Employment Contracts: What to Know and What to Avoid

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“CEO Employment Contracts: What to Know and What to Avoid” was the discussion topic of the May 3, 2007 installment of the Legal:GPS Web conference series hosted by Foley & Lardner LLP and Springboard Enterprises. Panelists were Cobalt Technologies, Inc. Chairman and CEO Pamela Contag, Foley Tax & Employee Benefits Partner Leigh C. Riley, and Foley Labor & Employment Partner Dabney D. Ware.

Employment and Severance Agreements

Employment and severance agreements are the tools with which executives define and establish their roles within the company. The agreements enable executives to outline the value of their current and continuing contributions to the company and ensure they are compensated appropriately now and into the future. Once an executive has entered into an employment and/or severance agreement, he or she should revisit the agreement at every stage of the company's development such as a merger or an initial public offering (IPO).

“One of the great things about employment and severance agreements: They give you peace of mind.”

Pamela Contag, Chairman and CEO, Cobalt Technologies, Inc.

Why Enter Into an Agreement?

Handshakes and verbal promises essentially mean nothing after an executive has terminated his or her employment with a company. Therefore, executives must ensure that their employment and severance agreements include certain provisions that protect their short- and long-term interests. Not only should the agreements be in writing, but they also must spell out each provision clearly so that they are indisputable 10 years later. Executives should keep in mind that the individuals interpreting the agreements in the future may not be the same individuals who originally negotiated the agreements.

“If it's not in writing, you don't have the right to get it.”

Leigh C. Riley, Tax & Employee Benefits Partner, Foley

When Should One Enter Into an Agreement?

Ideally, an executive should enter into employment and severance agreements upon starting his or her employment with the company. The provisions that should be included in the agreements do not change, regardless of whether the executive enters into separate employment and severance agreements, a joint employment and severance agreement, or simply a severance agreement in which the executive is considered an employee at will.

What Should the Agreements Include?

Employment and severance agreements should include provisions clearly outlining the following:

- > Job titles and responsibilities
- > Salary
- > Bonus structure
- > Vacation time
- > Expense reimbursements
- > Continued benefits upon termination
- > Outside responsibilities
- > Reporting structures
- > Noncompete restrictions
- > Acceleration of stock vesting upon termination
- > Termination definitions

Each provision must be defined clearly and with specificity because it may affect other provisions of the agreements. For instance, a reduction in job titles or responsibilities may trigger an involuntary termination, which in turn may trigger the severance agreement. Also, an expansion of job responsibilities may trigger an reexamination of the compensation provisions.

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If the executive is bringing or will be creating intellectual property (IP) that will be used by the company, the agreements should address the executive's ownership of that IP.

“I think it is very important for executives to find a personal attorney. Speaking as a corporate attorney, I'm there to look out for the interests of the company.”

Dabney D. Ware, Labor & Employment Partner, Foley

Regardless of whether the executive is able to secure an employment agreement, a comprehensive severance agreement should be obtained. Optimally, the agreement should include a full year of severance. The agreement should be reexamined and expanded in cases where the company is going through a merger to allow the executive to focus on the merger rather than diverting his or her attention to searching for another job. The agreement also should allow the executive to leave with the assets he or she brought to the company. To achieve this, the agreement should include retention provisions regarding customers, employees, development strategies, marketing strategies, and confidential information that he or she brought to the business. Finally, a personal attorney always should be hired to review the agreement, since the corporation's attorney is looking out for the best interests of the corporation rather than the executive.

Equity Arrangements as Part of the Employment and Severance Agreements

Equity arrangements are common forms of compensation contained in employment and severance agreements. Equity arrangements are

stock options, restricted stock, and similar compensation that is measured in relation to the value of company stock or limited liability company (LLC) interests. Employment and severance agreement provisions regarding equity arrangements should be very specific, including exact dates and amounts of stock promised. The executive should document in the employment and severance agreements the amount he or she is paid both before and after termination. Executives also should obtain and review a copy of any stockholder agreement into which he or she is required to enter when exercising a stock option.

Tax Consequences of Employment and Severance Agreements

Finally, the executive should consult a tax expert to address the possible tax consequences of the different types of his or her compensation. Specifically, the executive should investigate Internal Revenue Code Section 280G dealing with parachute payments and Section 409A regarding nonqualified deferred compensation arrangements, as these laws may affect an executive's compensation adversely.

Summary

Employment and severance agreements are necessary for executives to ensure compensation both during and after employment as well as to define their roles within the company and provide peace of mind. Executives should make sure they understand the intricacies of each of the numerous provisions that may be included in these agreements, particularly compensation during and after employment, how the provisions work together, and possible tax consequences. Most importantly, executives should consult personal attorneys to protect their best interests and to help them fully understand the implications of their agreements at every stage of employment.

