Executive employment agreements

Design and application

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The $75 million severance package for the CEO that landed the company in Chapter 11 is not just the stuff of press legend, but problems with excessive severance should not be allowed to tarnish all employment agreements.

It is perfectly possible to offer almost everything that can be offered in an employment agreement without the agreement. Executives can receive:

- signing bonuses and/or make whole payments;
- minimum level of base salary;
- eligibility for annual and long-term incentive schemes;
- eligibility for welfare and other benefits (welfare benefits consist of life insurance and health and dental insurance, as well as other benefits that are provided to employees for their general welfare);
- eligibility for retirement benefits;
- termination arrangements.

Employment agreements can, and do, take many forms. Here are some of them:

- full employment agreement;
- group severance agreement that individual parties are invited to sign;
- group change of control agreements that individual parties are invited to sign;
- letter agreements;
- separation agreements;
- restrictive covenants;
- fixed term contracts;
- rolling contracts (contracts that renew either daily, weekly, monthly or annually);
- post retirement agreements;
- consultancy agreements.

Reviewing existing contracts I

- what were the circumstances that led to the need for an agreement?
- were they sufficient justification for an agreement?
- assuming they were, are the circumstances that led to the need for an agreement still in place?
- are the company’s potential costs under the agreement excessive?
- would termination of the agreement with continued employment trigger severance benefits?
- how much would the company have to compensate the officer if the agreement was terminated?
- what message would be sent to stakeholders if the agreement was terminated by mutual accord?

Reviewing existing contracts II

- Review all existing contracts. Are there elements that need amendment, such as potential termination costs, renewal dates, restrictive covenants?
- Can we afford to pay for all our potential severance liabilities under all stages of financial health?
- Review the definition of “cause” in existing agreements and see if it can be broadened.
- Can equity plans and employment agreements be amended so that awards only vest acceleratedly on a no-fault termination and not simply on a change of control?
- Are any excise tax gross-up provisions strictly necessary?

Designing a new employment agreement I

- do the board and the company benefit from the existence of an agreement?
- does the employee benefit from the existence of an agreement?
- can the board offer similar provisions under existing compensation and benefits plans without an agreement?
- how is the existence of an agreement with this employee going to affect the employment status and morale of other senior officers who may or may not be serving under employment agreements?
- how will an agreement affect the relationship between the board and the officer?

Designing a new employment agreement II

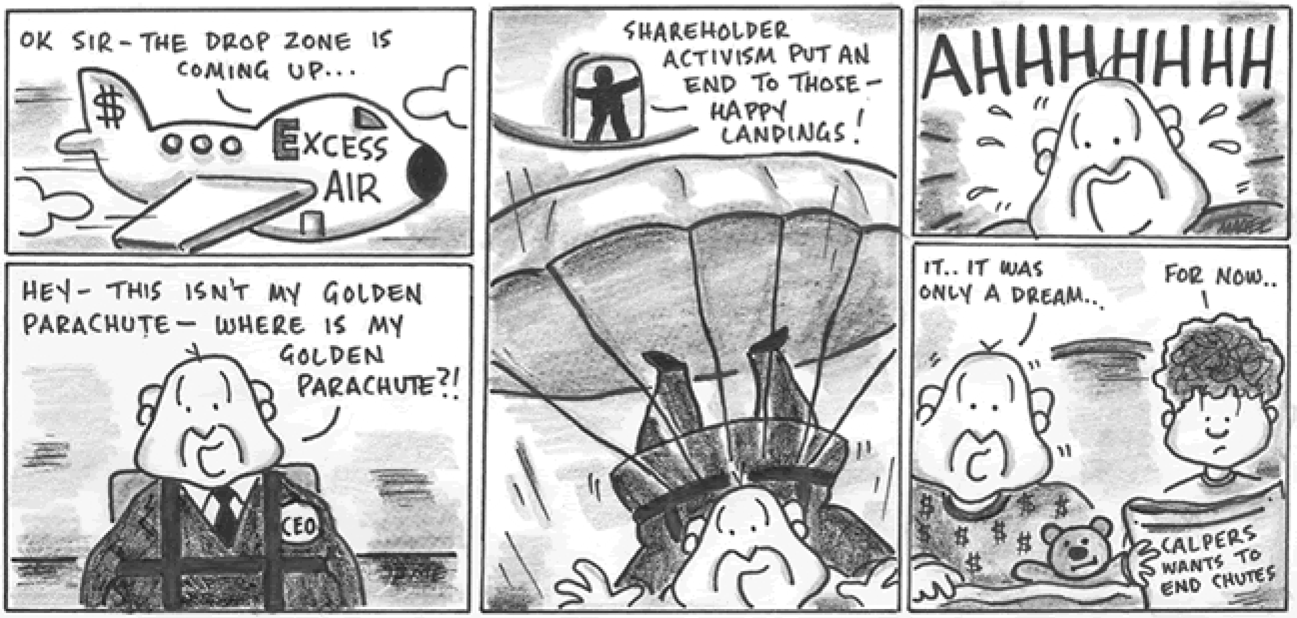
- Should the board have a set policy on golden hellos? Payment or non-payment? Or do we need to stay flexible to react to different circumstances?
- Review any policy on guaranteed bonuses.
- Does the compensation committee have a properly designed compensation policy to incentivize new hires?
- In any new employment agreements, what are the elements that we would do differently? Length of contract? Make-up of severance? Adoption of offset and mitigation clauses?
- Do our current agreements provide the company with adequate protection in terms of covenants, change of control situations and misconduct?


YOUNG ROBERT NARDELLI...
HE SAYS HE WON'T CLEAN HIS ROOM UNLESS WE SIGN THIS CONTRACT GIVING HIM 10 TIMES HIS CURRENT ALLOWANCE, A SIGNING BONUS AND AN EVEN BIGGER EXIT PACKAGE... AND THAT'S IF HE CLEANS OR NOT...
CONTRACT

Golden hellos – the beginning:

- make-whole payments;
- inducement awards;
- signing bonuses;
- hiring bonuses;
- guaranteed bonuses;
- joining bonuses;
- initial awards;
- compensation for income opportunities foregone;
- reimbursement for benefits forfeited from a former employer.

- If executives are made whole for all forfeited compensation, the incentive and retentive purposes of these payments are completely undermined.
- This is the case at both the company from which the executive is being hired, as well as the hiring company.
- The practice of make-whole payments sends a message to executives at all the companies involved that neither tenure nor performance is properly required for any payout to be earned, since, even if executives leave, they will be compensated by someone.
- This is neither in the interests of companies themselves nor of stockholders.



OK SIR - THE DROP ZONE IS COMING UP...
EXCESS AIR
HEY - THIS ISN'T MY GOLDEN PARACHUTE - WHERE IS MY GOLDEN PARACHUTE?!
CEO
SHAREHOLDER ACTIVISM PUT AN END TO THOSE - HAPPY LANDINGS!
AHHHHHHH
IT.. IT WAS ONLY A DREAM..
FOR NOW..
CALPERS WANTS TO END CHUTES

Reducing potential severance benefits:

- reduce the typical length of executives' contracts;
- do not include incentive payments as part of severance benefits;
- withhold unearned signing or retention bonuses;
- vest retirement benefits according to actual service;
- unvested stock options and other restricted equity awards should be forfeited;
- do not pay severance benefits to an executive at the same time as consultancy fees;
- do not pay severance benefits to an executive at the same time as retirement benefits;
- cease provision of office space, administrative support, corporate transportation, financial counseling and subsidized club membership at the termination date.


NYSE
...AND DON'T COME BACK!
THAT'LL SHOW HIM...
$140 MILLION
MCGEE
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