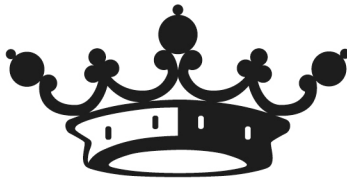


I N S I D E T H E M I N D S

Recent Changes in Employee Benefits and Executive Compensation

*Leading Lawyers on Counseling Clients,
Understanding New Executive Compensation and
Severance Practices, and Responding to Recent
Changes to COBRA and ERISA*



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Negotiating C-Level
Employment Agreements
after the Rescue

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Just as this chapter is being submitted to the editors, Credit Suisse announces a new compensation plan in line with G-20 “best practices,” essentially vesting the cash portion of the annual bonus over three years, the stock portion over four years, and in both instances, scaling the annual amounts up, down, or clawed back depending on annual returns on equity and the performance of the particular business unit. . . .

Change is hardest on those who are unprepared for change. As the compensation landscape is changing almost daily, we too must adapt our methods and goals. This chapter describes some principles and approaches that will help you effectively negotiate executive employment agreements in what I call “the post-bailout era after the hundred-year flood,” or, as in the title of this chapter, “after the rescue.”

. . . Despite the markets having executed the largest claw-back in history and having done so more ruthlessly and efficiently than could ever have been done by governmental action—the Dow Jones Industrial Average fell an astounding 7,721 points between its October 2007 high and March 2009 low—the likelihood of additional legislative, executive, and judicial action involving executive pay, including claw-backs, is high,¹ and the continued and heightened scrutiny by the public, and by public advocates, is a certainty.²

At a time when executive pay is under an electron microscope, it is important to know what you really need to obtain in an executive employment letter, why that is so, and how to go about negotiating such a letter. . . .

¹ See, e.g., Shareholder Bill of Rights Act of 2009, S.1074 111th Cong. (2009); Corporate and Financial Institution Compensation Fairness Act of 2009, H.R. 3269 111th Cong. (2009); Excessive Pay Shareholder Approval Act, S.1006 111th Cong. (2009) (all pending in Congress). See also court proceedings such as *SEC v. Bank of America*, No. 09-6829 (S.D.N.Y. Aug. 3, 2009).

² New York Attorney General Andrew Cuomo investigation into bonus payments

. . . The benefits of protections afforded by a traditional agreement may be outweighed by the certain public disclosure and criticism of these employment agreements. Therefore, in negotiating an agreement in this new era, it is important to keep these ten points, which are not necessarily consistent, in mind:

1. First, the greatest protection an executive has comes from his or her own abilities.
2. Second, the most important item an executive needs to ensure compensation, longevity, and fair treatment on the way out is a “seat at the table”—membership in the highest-ranking management committee chaired by the chief executive officer, or, in the case of the chief executive officer, reporting to the board of directors and a non-executive chairperson.
3. Third, the single most overlooked element of a good employment agreement is whether it accounts for the resources the executive needs to succeed, builds in a commitment to such resources, or gives the right to exit cleanly, quickly, and unencumbered if the commitment is unfulfilled.⁸
4. Fourth, the greatest leverage for the well-performing executive comes from the ability to walk away at any time and with few if any post-employment restrictions.
5. Fifth, nothing is forever. Like baseball managers, even the best are hired to be fired.⁹
6. Sixth, your client only wants to be rich once.¹⁰ No one wants to lose his fortunes and then have to start all over again. The employment agreement must provide complete downside protection and indemnification,¹¹ including the right to advance payment of legal fees and expenses (vested on signing) or directors and officers insurance including payments from any indemnification trust. Claw-backs need to be scrutinized and negotiated with complete awareness of the risks they present. For

⁸ A resignation pursuant to a “good reason” provision will generally nullify a non-competition clause contained in a contract and hence allow the executive to continue his or her career immediately after termination. See, e.g., M.L. Mikva, *Drafting Confidentiality, Non-Compete, and Non-Solicitation Agreements: The Employee’s Wish List*; ABA Regional Institute, *Labor and Employment Law: The Basics*; *Trade Secrets, Covenants Not to Compete, and Non-Solicitation Agreements: Basics* available at www.abanet.org/labor/basics/tradesecrets/papers/mikva.pdf.

example, an agreement requiring an executive to repay a signing bonus to the company if the executive's employment terminates within the first year will expose the executive to full repayment in the event that he or she dies or is terminated by the company without cause. Scrutinizing the wording of the claw-back and ensuring that amounts are not clawed back for the wrong reasons are vital to protecting the executive from the vagaries of life, human nature, and the marketplace.

7. Seventh, carefully read and be prepared to negotiate every word of the boilerplate. This is not being nit-picky. An iron-clad contract is, by definition, a contract wrapped in boilerplate.
8. Eighth, listen to your client and understand what is most important to the individual.
9. Ninth, a negotiation is not a competition to see who wins the most changes in the contract. Don't lose focus on the underlying business deal.
10. Tenth, close the door, take the phone off the hook, turn off your Blackberry, and think. Read the agreement and imagine that your client has been fired, or quit, or the company announced a merger. Think of all the things that could go wrong and how the contract operates under such circumstances. And think some more. Then read the contract a few more times.

Noticeably absent from this list are what most would recognize as the traditional features of a well-negotiated agreement—signing bonuses, multi-year guarantees, golden parachute severances, tax gross-ups, accelerated vesting upon termination, and unique perquisites. These are for the most part no longer politically desirable, even where they may still be lawful, . . .

Unless your client is leaving an existing position before bonus season, a guaranteed bonus, let alone multi-year guarantees, is rarely defensible by the compensation committee that must approve them. That matters little when

⁹ Casey Stengel won ten pennants and seven world championships in twelve years with the Yankees before he was fired after losing the 1960 World Series; Joe Torre won six pennants and four world championships in twelve years prior to his ouster. High-level success breeds a demand to continue such success.

¹⁰ See, e.g., executives whose fortunes were in shares of Lehman Brothers, Bear Stearns, or Citigroup.

¹¹ See, e.g., Del. Code Ann. tit. 8, § 145 (West 2009).

you consider who your client is, what he or she went through and what he or she has proved. For that client, your negotiating refrain should be “I don’t need a guaranteed bonus or a fixed term of employment. Give me the human capital, infrastructure, and budget envisioned by my business plan. Give me the authority to carry out my plan. Give that to me in writing. My compensation will flow from the company’s success and improved shareholder value.”

Most importantly, the agreement should emphasize the executive’s authority and the company’s commitment to the business plan. With severance agreements and accelerated vesting disfavored and sometimes outright prohibited, “good reason” exits that result in reduced post-employment restrictions become the favored negotiated answer to the question, “What happens if the company does not give me the tools I need to be successful?”

What is “good reason”? Simply stated, good reason is the existence of explicit conditions that excuse the executive from performing. Good reason conditions may allow the executive to resign his or her employment without penalty. . . .

. . . The most common conditions giving rise to the right to quit for good reason are: (1) material reduction in duties, responsibilities, authority, or status; (2) a reduction in the compensation the company has bound itself to pay pursuant to the contract; (3) a requirement for the executive to relocate outside of a certain radius from where he or she now works; or (4) a change in control of the company or, alternatively, a failure of the successor entity to assume the contract.

Good reason is the ultimate hedge for an executive to leave the company in the event that the company effectively blocks the executive from instituting and running his or her business plan and reaping the benefits of success. . . .

. . . Conclusion

Public opinion, shareholder scrutiny, regulatory changes, and legislative initiatives after the bailout require that we rethink what goes into an employment agreement that serves the interests of our clients. The new paradigm of a well-negotiated C-level agreement is one that puts your client in the best position to be successful and relies on that success to determine appropriate compensation and protect against termination. The added benefit is that such an agreement makes the client and the company stand out as exemplary models of good governance and thoughtful compensation policy.

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In each of the past three years, Mr. Eckhaus has been recognized as a “Super Lawyer” in the field of employment law, and in May 2009, he was named by Human Resource Executive as among the “100 Most Powerful Employment Lawyers in America” and listed among the top fifteen in New York. He is on the advisory board of the University of California at Hastings Law School Center for WorkLife Law, the Cornell University Library Advisory Council, and he is a member of the Association of the Bar of the City of New York. He is a sought-after speaker on the design of compensation plans, executive pay, employment agreements, and statutory civil actions.

A Rhodes Scholar nominee, Mr. Eckhaus earned his B.S. from Cornell University in 1972 and his J.D. from Cornell Law School in 1976. He is admitted to practice in New York and New Jersey, the U.S. District Courts for the Southern and Eastern Districts of New York, the District of New Jersey, the U.S. Court of Appeals for the Second Circuit, and the U.S. Supreme Court. . . .