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Executive Employment Agreements

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Introduction[1]

In the United States where employment is predominantly at-will, employers generally offer employment agreements to key management and other executive talent in order to attract and retain them. Offering these employees a certain level of job protection for a certain amount of time as well as compensation that rewards both short and long term performance is critical to achieving this end.

Often, these protections and promises will be contained in an agreement which encompasses representations that an employee is legally bound to abide by, as well as restrictions on his or her conduct and behavior during and post employment. While the employer may want the employee to accept the agreement as drafted, a savvy employee will hire counsel in order to negotiate a more balanced agreement that represents both parties' interests.

Also, in most states contracts are construed against the drafters. In employment agreements in particular, the drafters are almost entirely the employers and employees. They may respond to the draft and leverage the situation only when and if they are in a position to do so. That said, employees will rely on counsel to secure their employment, protect them from liability, and to avoid overbroad restrictions during employment and after it ends.

However, recent legislation enacted as a result of the economic downturn and the financial crisis has added new challenges for executives, the companies that employ them, and the attorneys negotiating executives' employment agreements. Given the Dodd-Frank Wall Street Reform and Consumer Protection Act,[2] the impact of § 409A of the Internal Revenue Code,[3] and other state and federal legislation,[4] companies are being forced to change their compensation structures, their risk tolerance and the agreements and compensation arrangements they can offer their executives. As a result, it takes more than the mere skill of challenging boilerplate provisions to negotiate a fair and balanced executive employment agreement that truly protects an executive in the short term, as well as the long term.

[1] The authors wish to acknowledge Wayne N. Outten's chapter *Representing the Executive* in the Executive & Director Compensation Reference Guide, which served as an inspiration for this chapter.

[2] Pub. L. 111-203, § 956, 124 Stat. 1376, 2011-2018 (2010).

[3] I.R.C. § 409A, added to the Internal Revenue Code by § 885 of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418.

[4] The discussion of relevant regulations and legislation in this chapter, whether related to executive compensation or taxation, is limited only to those regulations that may impact executive compensation and taxation.

Business and Legal Issues

Executive employment agreements contain two broad categories of substantive issues, business and legal. While the two may overlap, the process for negotiating each can be quite different. Every well-structured employment agreement should include, at a minimum, the following business terms:

- the length of the employment;
- the title, position, and a description of the duties and responsibilities;
- the compensation package, including salary, bonuses, and commissions; and
- benefits such as health and life insurance, vacation, and 401K matching or other applicable pension plans.

Senior executive agreements will often include equity compensation arrangements such as stock options, restricted stock, deferred compensation, and supplemental retirement benefits. Many of these benefits have forfeiture or noncompetition provisions tied to them. These benefits, while providing incentives to employees, can make it difficult for an employee to resign without leaving a valuable package behind. In addition, as discussed below, there are new tax consequences and government regulations that are changing the nature of these benefits in significant ways. In complex compensation deals, a compensation expert or tax lawyer should be consulted to determine what financial terms would best meet the employee's tax needs and lifestyle.

Once the business terms are agreed to and both parties have invested in the process, it is time to engage in a more aggressive negotiation over the legal issues that remain. The following issues are contained in almost all employment agreements:

- the term of employment;
- the definitions and grounds for termination or resignation;
- the effect of a change in control;
- the effect of termination on bonuses, equity compensation, and other aspects of compensation and benefits;
- severance;
- the nature and scope of any restrictions on present and future employment, i.e., noncompetes, nonsolicitation, confidentiality;
- notice requirements, waivers, remedies for breach, and mechanisms for dispute resolution such as arbitration or mediation, choice of law, and jurisdiction.

From an employee's perspective, the essential legal terms worth fighting for concern the grounds for termination, how termination effects compensation and severance, and what, if any, restrictions there are on future employment.

Current Regulations

Any attorney negotiating an employment agreement must be familiar with the current regulations that affect employee compensation and should know when to seek the assistance of a tax adviser.

Section 409A of the Internal Revenue Code

In regard to the tax issues, one of the most important tax regulations that has recently affected employment agreements is § 409A of the Internal Revenue Code (I.R.C.). Section 409A was added to the I.R.C. by § 885 of the American Jobs Creation Act of 2004 and became effective on Jan. 1, 2005.[5] Section 409A regulates the tax treatment of "nonqualified deferred compensation." The Internal Revenue Service issued initial guidance on Dec. 20, 2004, and final regulations were published on April 17, 2007.[6] The final regulations became effective and the transition period expired on Jan. 1, 2009. During the transition period, various companies modified their plans in order to comply with § 409A standards for deferred compensation and preserve favorable tax treatment for plan participants or "service providers" (e.g., employees).[7]

Section 409A provides that unless a "nonqualified deferred compensation plan" complies with various rules regarding the timing of deferrals and distributions, all vested amounts deferred under the plan for the current year and all previous years become immediately taxable (including a 20 percent penalty tax) to the employee.[8] The result of these restrictions is that most of the details under a deferred compensation arrangement must be in writing and defined from the beginning of the deferred compensation arrangement (unless one of the exceptions from the regulations applies). For purposes of § 409A, a deferred compensation plan is one that "provides for the deferral of compensation if, under the terms of the plan and the relevant facts and circumstances, the service provider has a legally binding right during a taxable year to compensation that, pursuant to the terms of the plan, is or may be payable to (or on behalf of) the service provider in a later taxable year."[9] Under § 409A, a "plan" includes an employment agreement.[10]

Regulations Governing Executive Compensation

Since the financial crisis of 2008, a number of laws have been proposed and enacted that are aimed at governing and limiting the payout of executive compensation. Therefore, it is important for executive's counsel to be aware of these latest developments.

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[5] *See* American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 885, 118 Stat. 1418, 1634 (2004) (codified at I.R.C. § 409A (Supp. V 2005)).

[6] The regulations, titled "Application of § 409A to Nonqualified Deferred Compensation Plans," were issued April 10, 2007, and appeared in the Federal Register April 17, 2007. 72 Fed. Reg. 19,234.

[7] For definition of "Service Provider," *see* Treas. Reg. § 1.409A-1(f). In addition to employees, "service providers" can include independent contractors.

[8] I.R.C. § 409A(a)(1)(B)(i)(II).

[9] Treas. Reg. § 1.409A-1(b)(1).

[10] For definition of "Plan," see Treas. Reg. § 1.409A-1(c). The concept of "plan" as covered by § 409A includes many different types of compensation and benefit plans in which executives participate.

Initially, significant limitations on executive compensation were enacted by the American Recovery and Reinvestment Act of 2009 (ARRA),[11] which was signed into law on Feb. 17, 2009, by President Obama. Among other things, ARRA amended § 111 of the Emergency Economic Stabilization Act of 2008 (EESA)[12] that related to executive compensation limitations for financial institutions receiving funding under the Troubled Asset Relief Program (TARP). Under the original terms of EESA, only the top five most highly paid executives of a public company receiving assistance under TARP were subject to compensation limitations and restrictions. ARRA significantly expanded these limitations and restrictions to as many as the next 20 most highly compensated employees, or to such higher number as the U.S. Department of the Treasury may determine is in the 'public interest.' Further, ARRA went so far as to revisit compensation determinations made prior to its enactment to confirm that such prior compensation determinations were consistent with TARP and not contrary to the 'public interest.'

Since many companies paid off their TARP debt, and thus the executive compensation limits set out by ARRA have become less applicable or relevant, U.S. regulators turned to new legislation that could regulate and limit executive pay. The result was the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)[13] signed into law on July 21, 2010. Dodd-Frank is broad reaching legislation that includes new rules for mortgage lending, risk management, product development, investment management, customer service/communications, and executive compensation. Specifically, § 956 of the Act addresses incentive compensation with a focus on prohibited and excessive compensation.[14] Although the Dodd-Frank Act was originally meant to focus on Wall Street, the executive compensation provisions aim to significantly modify corporate governance and disclosure practices for almost all U.S. public companies. The new law ushers in fundamental changes in executive compensation disclosure, compensation committee independence, shareholder voting rights, and clawbacks, which will be implemented by various federal regulations over the course of the next two years.

In this regard, on Jan. 25, 2011, the Securities and Exchange Commission (SEC) adopted final rules[15] implementing certain provisions of the Dodd-Frank Act. Specifically, § 951 amended the Securities Exchange Act of 1934[16] by adding a new § 14A(a)(1),[17] the "say-on-pay" provision, which requires all public companies to present to their shareholders an advisory resolution to approve compensation of its named executive officers, as disclosed pursuant to the executive compensation disclosure rules,[18] at least once every three years. The frequency of these advisory votes must be determined by a separate shareholder resolution no less than every six years and shareholders may elect to have the "say-on-pay" vote every one, two, or three years, with initial votes to be held on or after Jan. 21, 2011.[19] Further, § 951 also modified the Exchange Act by adding a new § 14A(b)(1) regarding "golden parachute" disclosures, requiring any person making a proxy solicitation relating to sale, acquisition, or merger to include disclosure of any compensation arrangements between the soliciting person and the company's named executive officers.[20]

While § 951 applies to all public U.S. companies, the provisions do not impose say-on-pay or say-on-frequency advisory votes on small reporting companies with assets of less than $75 million until after Jan. 21, 2013. Disclosure requirements regarding "golden parachute" payments in connection with change in control transactions took effect April 25, 2011. Finally, TARP companies are not subject to the new rules while they are still under TARP reporting rules.

Most recently, on the heels of the SEC's adoption of the Dodd-Frank Act provisions, the Federal Deposit Insurance Corporation (FDIC) and other agencies proposed new rules regarding incentive compensation paid to financial institution employees.[21] Proposed by the FDIC on Feb. 7, 2011, these rules will specifically apply to all banks and financial institutions with assets greater than $1 billion that provide incentive compensation to their employees. All "covered financial institutions"[22] will be required to annually report incentive compensation arrangements to their primary regulators within 90 days of the fiscal year end. The definition of "covered" persons includes any executive officer, employee, director, or principal shareholder of a covered financial institution. There is no specific category of employee that is outside of the scope of the rules since they are tailored

[11] Pub. L. No. 111-5.
[12] Pub. L. No. 110-343.
[13] Pub. L. No. 111-203, *supra* note 2.
[14] 12 U.S.C. § 5641.
[15] Securities Act Release No. 33-9178, 76 Fed. Reg. 6010 (Feb. 2, 2011).
[16] 15 U.S.C. § 78a et seq.
[17] 15 U.S.C. § 78n-1(a)(1).

[18] See Item 402 of Regulation S-K.
[19] 15 U.S.C. § 78n-1(a)(2).
[20] 15 U.S.C. § 78n-1(b).
[21] Exchange Act Release No. 34-64140 (March 29, 2011), jointly proposed by the federal banking agencies—FDIC, SEC, Office of the Comptroller of the Currency, Federal Reserve System, Office of Thrift Supervision, and National Credit Union Administration—published in 76 Fed. Reg. 21,170 (April 14, 2011).
[22] The Dodd-Frank Act defines "covered financial institution" to include any of the following types of institutions that have $1 billion or more in assets: (A) a depository institution or depository institution holding company, as such terms are defined in § 3 of the Federal Deposit Insurance Act (FDIA) (12 U.S.C. 1813); (B) a broker-dealer registered under § 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o); (C) a credit union, as described in § 19(b)(1)(A)(iv) of the Federal Reserve Act; (D) an investment adviser, as such term is defined in § 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11)); (E) the Federal National Mortgage Association (Fannie Mae); (F) the Federal Home Loan Mortgage Corporation (Freddie Mac); and (G) any other financial institution that the appropriate federal regulators, jointly, by rule, determine should be treated as a covered financial institution for these purposes.

to apply to all employees whose duties expose the organization to a possibility of a material financial loss.

The proposed FDIC rules also impose heightened standards for "larger covered financial institutions," or institutions with $50 billion or more in consolidated assets.[23] For these larger institutions, the rules require that at least 50 percent of incentive-based payments be deferred for a minimum of three years for designated executives. Moreover, boards of directors of these larger institutions must identify employees who individually have the ability to expose the institution to substantial risk (in addition to executive officers), and must determine that the incentive compensation for these employees appropriately balances associated risk and rewards according to enumerated standards. After a 45 day comment period after publication,[24] the final rules are expected to be published in 2011 and will most likely be effective for fiscal years beginning in 2012.

According to the FDIC, the proposed rules would move the U.S. closer to aspects of international compensation standards. The FDIC believes that the proposed regulations would help eliminate incentive-based compensation arrangements that encourage inappropriate risk or may result in material financial losses. According to the proposed rules, each "covered" company must institute policies and procedures for incentive-based compensation arrangements that are commensurate with the size and complexity of the institution and provide annual reports on incentive compensation structures to appropriate federal regulators.

All of the regulations discussed above make clear that the days of paying excessive executive compensation unchallenged by regulators and shareholders is over. It is also clear that with "say-on pay" and other provisions in the Dodd-Frank Act, public companies will become much more shareholder driven in regard to their executive compensation policies. For example, policy guidelines used by Institutional Shareholder Services Inc. (ISS) to formulate voting recommendations on executive pay and corporate governance issues recommends annual shareholder votes on executive compensation,[25] includes on its list of egregious pay practices single trigger change in control pay provisions, tax gross ups, and single trigger vesting of unvested equity in the event of involuntary termination.[26] An attorney negotiating an employment agreement for an executive joining the ranks of a public company or a financial institution must be aware of all of these statutory and regulatory limitations, as well as proxy adviser policies and guidelines and how they will affect his or her client.

Key Terms of Employment Agreements

Term of Employment and Renewal

An employment agreement can have a fixed or indefinite term. In either case the threshold question is under which circumstances can the employment be terminated and what are the consequences of the termination of employment or the expiration of the term.

With a fixed term, what happens at the end of the term is most important. Under the laws of some states, an employment agreement is automatically renewed either for a period of the initial term or for one year, unless the agreement provides otherwise. In other states, the agreement expires, unless it provides otherwise.

An employment agreement with a fixed term should address exactly what happens on the expiration and how the agreement could be renewed. Unless the employee is entitled to severance upon nonrenewal, an employee should not risk becoming at-will by not having a renewal option. If there is no mechanism for renewal, a provision that states that certain benefits (including severance) survive the expiration of the term may help avoid an at-will situation.

Many agreements have a default provision which states that in the event that neither party gives notice to the other a certain number of days before the expiration of the term, the agreement renews automatically for a particular period of time. Other agreements provide that the parties agree to discuss in good faith the renewal or extension of the agreement beginning a certain number of days before expiration.

Finally, an employment agreement with an 'evergreen' or indefinite term in the agreement continues until either party gives notice of termination of employment. Having an 'evergreen' contract is advisable only in the event that the agreement provides for fair and reasonable severance.

Position/Title/Duties and Responsibilities

The employment agreement should describe the employee's duties and responsibilities with as much specificity as possible. At the very least, the agreement should set forth the employee's title and position and a short description of job duties. Among other things, the description should include the employee's reporting structure and authority. Further, if there is something specific that has been promised to the employee during the negotiation that may affect the scope of his or her employment, it should be included in the description. For example, a promise to have a seat on the employer's board or the executive committee should be included as a term of the agreement. The agreement should also specify the place of employment and whether the employee will be expected to travel.

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[23] The proposed rules define larger covered financial institutions relative to the applicable agency. For the federal banking agencies and the SEC, the definition covers those financial institutions with total consolidated assets of $50 billion or more. For credit unions the definition applies to those financial institutions with total consolidated assets of $1 billion or more. For the FHFA, all Federal Home Loan Banks with total consolidated assets of $1 billion or more are larger covered financial institutions.

[24] *See* 76 Fed. Reg. 21,170 (April 14, 2011).

[25] See *supra* note 17. Dodd-Frank requires only that companies "[n]ot less frequently than once every 3 years" hold a shareholder say-on-pay vote on executive compensation.

[26] 2011 US Policy Summary Guidelines, available at http://www.issgovernance.com/files/ISS2011USPolicySummaryGuidelines20110127.pdf.

Depending on the level of the employee's position, an employment agreement may include a description of permitted "outside activities." These provisions are typical for higher level executives as the company wants to protect itself from impropriety and breaches by fiduciaries. Generally, an executive is allowed to keep some of his nonemployment-related activities such as board seats for nonprofit or for-profit organizations as well as speaking or teaching engagements but these should be clearly delineated to avoid a lawsuit for lost profits later on. Usually, as long as the employee discloses his or her outside activities to the prospective employer and they do not conflict with the performance of executive's duties and responsibilities or compete with the employer's business, the agreement will not prohibit the executive's continued involvement in such activities.

Ultimately, the more detailed the job description is in the agreement, the more beneficial it can be to the employee over the term of employment. As discussed below, an employer's failure to live up to its representations about the employee's job can be grounds for a breach of contract claim, a "good reason" resignation or a defense to an employer's attempt to terminate the employee for "cause."

Compensation and Benefits

While the compensation package included in the employment agreement is usually negotiated by the employee and the prospective employer directly, an attorney negotiating the agreement should ensure that the total package is equitable and that all of the payments and benefits comply with current tax and other compensation-related regulations.

Base or Annual Salary

Every employment agreement should detail the base or annual salary the employee will be entitled to for the duration of the term and when it will be paid. The agreement should also detail the salary review mechanism, i.e., whether the employee's salary will be reviewed annually and whether the employee will be entitled to a raise during the term.

In regard to tax reporting or withholding, the agreement should state that all required taxes will be withheld and detail how often the employee will be paid. In regard to limitations on executive pay, attorneys should be aware of I.R.C. § 162(m) that limits the employer's deduction for compensation to certain covered employees of publicly traded companies to the extent that the compensation (including salary and bonuses) exceeds $1 million per year. Certain "performance-based" compensation is not subject to this deduction limit.[27]

Welfare Benefits

An employment agreement is critical to establishing an employee's entitlement to benefits during the term of employment or thereafter because compensation programs are generally at the discretion of the employer, whereby the employer can amend or delete benefits. The employee and his or her attorney should review all of the employer's benefit plans and understand how these plans will apply to the employee. Usually, the description of benefits in the agreement is minimal and states that the employee will be entitled to the employer's benefits. Rather, the agreement should state that the employee will receive the same benefits as other employees who are similarly situated. Of course, any special needs of the employee should be negotiated and included in the agreement.

In terms of providing certain welfare benefits, § 409A provides for exclusion from nonqualified deferred compensation plan status for various types of welfare benefits. These include certain medical reimbursement arrangements and any "bona fide vacation leave, sick leave, compensatory time, disability pay or death benefit plan." However, some welfare benefits under executive employment agreements may be nonqualified deferred compensation plans, including executive medical plans, executive life insurance, and others. During the negotiation of the agreement, it is important to be aware of these limitations and ensure that any welfare benefit plan that constitutes a nonqualified deferred compensation plan complies with the requirements under § 409A in order to avoid any penalties under this provision.

Perquisites (Perks) and Expense Reimbursements

The employment agreement should state that the employee will be entitled to reimbursement for expenses incurred in connection with the performance of his or her duties and responsibilities under the agreement. If there is something specific that has been negotiated such as a first class travel requirement, it should be included.

In regard to perks, the latest economic developments, current tax rules on expenses, and SEC reporting and disclosure requirements have made some perks obsolete. Certainly, the jets and memberships to golf clubs are not seen as often as they used to be and, in fact, an employer's participation in paying for such expenses may be prohibited or discouraged under ARRA, Dodd-

[27] However, note that under the ARRA rules, for the duration of the TARP limitation period, each TARP recipient is subject to the deduction limitations of § 162(m)(5), added to the I.R.C. by EESA. The provision imposes a $500,000 limitation on the annual deduction an employer may take for compensation paid to certain executive officers and does not contain any exclusion for performance-based pay that is otherwise available under § 162(m).

In addition, under the Patient Protection and Affordable Care Act (PPACA), Pub. L. No. 111-148, § 9014, adding I.R.C. § 162(m)(6), certain "covered health insurance providers" cannot take a deduction for compensation paid to an "applicable individual" in excess of $500,000 for any disqualified tax year beginning after Dec. 31, 2012, that is attributable to services performed during any tax year beginning after Dec. 31, 2009. The health insurer deduction limit applies to public and private entities and all service providers, rather than only "covered employees" as defined in § 162(m). The calculation of an applicable individual's compensation for a year includes all compensation from all members of any controlled group of corporations, other businesses under common control, or affiliated service groups under the qualified plan aggregation rules of I.R.C. § 414. See IRS Notice 2011-2, 2011-2 I.R.B. 260, Jan. 10, 2011.

Frank, and SEC regulations. But perks that are still allowable should be included. Under § 409A, if the perk is reimbursed more than a year after the year in which it was incurred, it may be treated as nonqualified deferred compensation.[28]

Incentive Compensation

Similar to salary, negotiation of the form and amount of incentive compensation usually takes place between the employee and the employer. However, the employee's counsel can advise the employee on the fairness of the offer based on the attorneys' knowledge of industry standards. Further, the employee's counsel can be instrumental in crafting the payments to comply with current tax and executive compensation regulations in order to avoid penalties or clawbacks.

The form and nature of incentive compensation differs across industries. Companies have various compensation plan arrangements and different abilities to pay their employees. However, any arrangement should have an equitable mix of short-term and long-term incentive compensation. The proportion of each type will depend on the economy and the amount of cash immediately available to the employer.

Short-term Incentive Compensation

Short-term incentive compensation is usually paid to the employee in the form of an annual bonus. Larger companies typically have standard incentive compensation plans describing how annual bonuses are accrued, which should be reviewed by the employee and his or her attorney. Smaller companies or start-ups may present the employee with targets and milestones based purely on performance and a possible range or a target for the annual bonus the employee may receive. Finally, many financial institutions just state in their employment agreements that their short-term incentive compensation is totally discretionary. Due to the current state of the economy, many companies (whether public or private) will have to justify their allocation of annual bonuses to their shareholders. The metrics and rationale for paying out these bonuses will likely be based on realistic individual achievements and performance targets, the employee's division or department performance, and the company's overall performance throughout the fiscal year.

After a negotiation, an employee should have an equitable package containing bonus guarantees or, at a minimum, fair criteria and reasonable targets. Realistic performance objectives can be set and described in the agreement. These may include achievement of specific EBITDA[29] targets, a certain level of sales, or other goals appurtenant to the employee's performance of his or her responsibilities under the agreement.

The agreement should state what will happen to the accrual of the bonus in the event the employee is terminated before it is paid, if the agreement expires before the end of the employer's fiscal year or if the bonus is in a deferred scheme and it has not vested at termination. In the event the agreement provides for any guaranteed bonus, any portion of the guarantee that remains unpaid when the employee is terminated should be paid out to the employee (sometimes in lieu of other standard severance). If no guaranteed bonus is contemplated by the agreement, the employee should at least receive a prorated portion of the annual bonus to the extent the employee fulfilled the detailed performance objectives described in the agreement.

Under § 409A, if an annual bonus is earned in one taxable year and paid in another, it may constitute a nonqualified deferred compensation plan. In the event employers pay part of the annual bonus shortly after the close of the year in which the services were performed and pay the rest in a later year, the timing and nature of the payments would be subject to § 409A and must comply with the distribution requirements under § 409A.[30] If the annual bonus must be paid in the year the services are provided or within 2½ months following the end of the employee's tax year or the employer's tax year, whichever is later (the "short-term deferral" rule under § 409A), it should not be a problem under the regulations.[31]

Finally, under ARRA and EESA, TARP recipients are prohibited from paying or accruing bonuses to their senior executive officers and a certain number of the most highly compensated employees, retention awards or incentive compensation during the TARP obligation period. An exception is the payment of long-term restricted stock that does not fully vest until the TARP obligation is completed, has a value in an amount that is no greater than one-third of the total amount of annual compensation of the employee receiving the restricted stock and is subject to any other terms the Secretary of the Treasury determines are in the public interest.[32]

As discussed above, under the proposed FDIC rules, top executives at major banks may have to defer at least 50 percent of their incentive compensation for three years. Additionally, traders who put banks at material risk may also be required to defer a significant portion of their bonuses.[33]

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[28] Treas. Reg. § 1.409A-3(i)(1)(iv) provides rules with regard to expense reimbursement and "in-kind" benefit plans. For definition of "in-kind" benefits, see Treas. Reg. § 1.409A-1(p).

[29] Earnings before interest, taxes, depreciation, and amortization.

[30] I.R.C. § 409A(a)(2)(A).

[31] If the agreement provides that the bonus "might" be paid within a 2½ month period, it will not meet the "short-term deferral" exception.

[32] The prohibition on incentive compensation has an exception for any bonus payment required to be paid pursuant to a *written employment contract* executed on or before Feb. 11, 2009. The Secretary of the Treasury has the authority to determine which employment contracts are "valid" for this purpose. ARRA instructs the Secretary of the Treasury to review bonuses, retention awards, and incentive compensation paid to senior executive officers and the next 20 highest compensated executives before the enactment of ARRA and determine whether any of those payments were inconsistent with the purposes of TARP or contrary to the public interest.

[33] See text accompanying notes 21-24.

Sign-On Bonus

The employee may also be granted a sign-on bonus as incentive for joining the employer's team or as a make-whole for compensation the employee forfeits by leaving his former employer. Whatever the reason for a sign-on bonus, it should be detailed in the agreement and attention must be paid to its taxation and payment dates. Under § 409A, if at the commencement of employment, the agreement gives the employee a legally binding right to payment in a future year, or years, the payment represents deferred compensation. Accordingly, unless the payment of the sign-on bonus is subject to a substantial risk of forfeiture or, following the year in which the sign-on ceases to be subject to a substantial risk of forfeiture it comes within the "short-term deferral" exception, the payment must comply with the permissible distribution requirements[34] under § 409A.

Clawback Provisions

With recent developments in the regulation of financial institutions and executive compensation, employers are frequently inserting clawback provisions into employment agreements and other executive compensation plans. Clawbacks are contractual provisions that require an employee to repay compensation following a specific event or other trigger. These provisions are usually triggered upon employee's termination of employment, in the event of an employee's misconduct, or upon an employee's departure and subsequent work for a competitor.

In addition to using clawbacks on a contractual basis, certain federal regulations allow clawbacks of executive compensation. The Sarbanes-Oxley Act of 2002 requires recoupment of certain bonuses and other incentive compensation previously paid to a chief executive officer (CEO) and a chief financial officer (CFO) of a public company if it is determined that their activities significantly contributed to a financial statement restatement, which resulted in a determination that the executives had received unearned incentive compensation as a direct result of their own misconduct. The enforcement of the clawback provision of Sarbanes-Oxley lies with the SEC and does not provide private plaintiffs standing to bring a claim against the CEO or the CFO.

ARRA also has clawback requirement that calls for recovery of any bonus, retention award or incentive compensation paid to a senior executive officer and any of the next 20 most highly compensated employees of a financial institution receiving TARP funds if the compensation was based on statements of earnings, revenues, gains, or other criteria that are later found to be materially inaccurate.

Under the Dodd-Frank Act,[35] each U.S. public company will have to implement a clawback policy. According to the Act, a company must recover from any current or former executive officer (following an accounting restatement due to material noncompliance with any financial reporting requirements), any incentive compensation (including equity grants) paid during the three-year period preceding the date that the company was required to prepare the accounting restatement that was based on the erroneous data. The clawback would be calculated as the excess amount paid on the basis of the restated results. Under the Act, there is no need to show any executive wrongdoing in order to recoup the compensation. Further guidance from the SEC is not expected until late 2011 with final rules likely to be effective for the 2012 proxy season, and as such, most companies have delayed implementing this clawback policy and are only enforcing the clawback policy currently required under Sarbanes-Oxley.

Aside from the regulatory clawbacks that protect shareholders and U.S. taxpayers, most clawback provisions create a contractual obligation to pay back incentive compensation or a sign-on bonus upon employee's termination or departure and should be carefully negotiated and drafted. In an employment agreement, the circumstances that would allow for any clawback on an annual bonus or a sign-on bonus should be limited to termination with cause or voluntary resignation without good reason. Further, any clawback trigger should be limited in time and scope. In regard to contractual obligation to pay back incentive compensation, the manner and timing of the payment should be carefully planned considering § 409A consequences, standard income tax consequences and any possible violations of wage laws that may be triggered if clawback provisions are not constructed carefully in an executive agreement or another compensation plan.

Long-Term Incentive Compensation

In order to retain talent, especially in a down economy, in addition to paying annual bonuses, companies grant long-term incentive compensation to employees. Long-term incentive compensation is often structured in a grant of equity or another long-term plan that will vest over a specific period of time. By granting long-term incentive compensation to employees, companies ensure that the employee is invested and motivated to stay with the company and perform well, as the employee is now an investor in the company's losses or profits.

Equity Compensation

Today, employers commonly provide a portion of an employee's compensation in the form of equity or deferred compensation. Equity may take the form of statutory or nonqualified stock options, restricted stock grants, phantom stock, performance shares, stock appreciation rights, and other kinds of compensation. Aside from making sure that each grant of equity or employee entitlement to future grants are referenced and detailed in the employment agreement (as well as what happens to the grant in the event of termination), it is essential that such grant of equity compensation complies with applicable tax rules.

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[34] I.R.C. § 409A(a)(2)(A).

[35] See Exchange Act § 10D, 15 U.S.C. § 78j-4, added by Pub. L. No. 111-203, Title IX, § 954.

From an employee perspective, it also makes sense to match the term of employment to the vesting of equity grants to ensure that the employee has an opportunity to vest in the equity during employment. Further, every equity plan should contain specific information regarding the termination and forfeiture of the equity and a waiver and acknowledgment section in which the employee attests to his or her knowledge and understanding of the terms.

Many equity plans, especially those of financial services companies, detail different consequences to the employee's equity compensation upon termination. Typically, the employee's counsel should negotiate arrangements so the employee does not lose his or her rights to the grant in the event he or she is terminated without cause or resigns with good reason. In this event, vesting may be accelerated and the employee would be entitled to a pay-out of such equity or the employee continues vesting in the equity as if employment has not ended and the employer imposes restrictions during the vesting period. These restrictions often include a non-solicitation provision of employer's employees and clients, a clause preventing the employee from disparaging the employer, and standard confidentiality and nondisclosure provisions. Typically, if the employee is terminated with cause or resigns from his or her employment without good reason or voluntarily, he or she forfeits the unvested equity and may even forfeit vested compensation that has not been paid out.

Under § 409A, stock options and stock appreciation rights are excluded from the treatment as deferred compensation if they meet certain requirements. In this regard, a stock option must have an exercise price no less than the fair market value of the stock on the date of grant to the employee. Shares of restricted stock are not deferred compensation for purposes of § 409A, while restricted stock units are deferred compensation that must comply with § 409A. Other forms of equity compensation grants should be examined carefully to determine whether their characteristics are those of deferred compensation. The application of the rules to equity plans and grants can be complicated and careful attention must be given as to how the rules apply to a particular form of equity compensation grant.

Other Long-Term Incentives

These include awards tied to performance over several years and could be included as additional incentives in the employment agreement. For purposes of § 409A, the issue is whether the long-term incentive compensation is paid in a taxable year after the year in which it is earned. Therefore, the long term incentive can come within the "short-term deferral" rule exception if it is paid within 2-½ months after the year in which it becomes vested.

Pension Benefits

In regard to pension benefits provided to the employee by the employer, an employment attorney or a tax adviser assisting the attorney must be aware of various tax consequences. In regard to § 409A, tax-qualified pension plans are excluded from nonqualified deferred compensation.[36] However, supplemental pension benefits provided to executives by agreements (or referenced in such agreements) are subject to § 409A. These nonqualified pension plans must comply with § 409A requirements of when payment of benefits under the plans can be made.[37]

Termination and Severance Provisions

In most employment agreements, the employer drafts grounds for termination as broadly as possible. Fixed term agreements usually provide for early termination under circumstances such as death, disability, and for "cause." Those more favorable to the employee also provide for resignation by the employee for "good reason."

Generally, employment agreements provide that in the event the employee becomes disabled, retires, or dies, the employer will pay to the employee or the employee's estate his or her accrued and unpaid salary through the date of termination. The agreement may also call for payment of any unused vacation time and a pro rata portion of an unpaid bonus. With respect to retirement, the agreement may specify additional benefits to which the employee may be entitled.

Notably, most termination provisions can be crafted in a manner that simultaneously maximizes the employee's protections and minimizes subsequent disputes with the employer in cases of employer-initiated terminations. For example, the type of disability that will trigger termination should be narrowly defined and also remain compliant with any of the employer's relevant disability plans.

Termination for "Cause"

Termination for "cause" often results in severe consequences for any employee. While the employee is generally paid any accrued and unpaid salary through the date of termination, the employee often automatically loses all benefits under the agreement, forfeits any unvested equity grants, and may even lose rights to elect COBRA and receive unemployment insurance benefits after termination. For these reasons, termination clauses—and the provisions concerning for "cause" terminations in particular—should be closely examined and drafted as narrowly as possible, limiting "cause" to willful, material, and intentional acts of malfeasance that could cause significant damage to the company. Further, in addition to providing for adequate notice of events triggering the termination for "cause," an agreement should provide for a cure for events that are curable. With this protection, an employer should be required to give the employee notification in writing of the alleged reasons for termination and reasonable time to remedy the situation.

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[36] I.R.C. § 409A(d)(1)-(2).

[37] I.R.C. § 409A(a)(2).

Resignation With "Good Reason"

Another important provision to include in employment agreements, especially for executives, is resignation for "good reason," which enumerates the grounds for which the employee may terminate the agreement and trigger the notice and severance benefits he or she would be entitled to if there was a termination without "cause." This clause provides a counterweight to an employer's for "cause" provision. Often, such "good reason" clauses permit the employee to end the employment relationship if the employer materially breaches the agreement, fails to provide employee with resources for carrying out the position, if the employer substantially reduces employee's duties, responsibilities, reporting line or compensation, or if there is a change in corporate control or structure. Similar to the "cause" definition discussed above, the "good reason" definition should include a notice and cure provision where the employee would be required to give the employer notification of the "good reason" triggers or events and the employer would have a certain period of time to cure these occurrences. As discussed below, § 409A has a safe harbor definition of "good reason" that includes a notice and cure requirement.

Notice, Severance Benefits, and Release Requirement

Regardless of whether the agreement is for an indefinite or fixed term (as discussed above), it should include some provisions concerning automatic or employer-initiated notice and termination. The notice requirement should be mutual and state whether the employee can be paid in lieu of notice.

In the event the employee is terminated without cause or resigns with good reason, the employee should be entitled to severance under the employer's plan or under the employment agreement. Severance usually includes both salary and health benefits and is paid following termination in either a lump-sum amount, or as continuation of salary for a number of weeks, months, or years. Many companies have separate severance plans that provide payments under certain situations and are formulaic.[38]

Depending on the grounds for termination, how long the employee has been at the company and what his or her position was will often determine how much severance the employee receives.[39] Severance should be negotiated and included in the employment agreement and be controlling, especially if a company's plan would give the employee less cash and benefits at termination. Depending on the level of employee's position, negotiating for six months to a year of severance and benefits in addition to a pro-rated annual bonus is a reasonable place to start the negotiation. Further, as discussed below, the amount of severance should be tied to the duration of any restrictive covenant the employee agrees to be bound by.

It is important to note that the employee's entitlement to severance under an employment agreement is usually contingent on employee signing a general release and waiver of all claims. Typically, any employment agreement provided by the employer will state that the release will be in a form satisfactory to the employer. In these situations, employee's counsel should negotiate that the release be in a form mutually satisfactory to both parties and review it in advance making sure that any restrictions are not broader in time or scope then are already contained in the employment agreement.

Termination of Employment: § 409A Considerations and Consequences

In order to comply with § 409A, the employment agreement must provide that no distribution of amounts that constitute nonqualified deferred compensation will be made prior to one of the permissible distribution events or a specified time.[40] This requirement is subject to exceptions that allow a number of special circumstances in which acceleration of distributions is permitted without violating § 409A.[41]

Under most employment agreements, severance payments are typically paid in connection with a separation in the form of an involuntary termination without cause by the employer (which under § 409A includes a resignation for "good reason"). Under § 409A, an employment agreement may provide for severance payments or "separation pay"[42] to be made to employees upon a "separation from service," which is a permitted distribution event under the regulation.[43] However, in order to comply with the regulation, the time and method of the payment must be specified (i.e., lump-sum versus installments) and comply with any other distribution requirements, unless it qualifies for one of the exceptions.

In connection with the discussion of different terminations typically covered in employment agreements, the following two exceptions should be noted, understood, and applied by attorneys. "Separation pay" arrangements that provide for payment only upon an involuntary termination of employment (i.e., a termination by the employer without cause or resignation by the employee for good reason that meets the requirements of § 409A) are not considered nonqualified deferred compensation under § 409A to the extent that a portion of the total amount of the "separation pay" does

[38] Some of these plans are governed by the Employee Retirement Income Security Act of 1974 (ERISA). *See* 29 U.S.C. §§ 1001-1381.

[39] TARP recipients are prohibited from making any severance payments to senior executive officers or any of the next five most highly compensated employees during the TARP obligation period. The reason for the employee's departure does not matter and they are only entitled to the payment for services performed or benefits already accrued. EESA § 111(c), as amended.

[40] I.R.C. § 409A(a)(2)(A)(i)-(vi).

[41] Treas. Reg. § 1.409A-3(j)(4) lists special circumstances in which acceleration may be permissible.

[42] Under § 409A, "separation pay" means an amount to which an individual obtains a right to payment only because of his or her separation from service.

[43] I.R.C. § 409A(a)(2)(A)(i).

not exceed the lesser of (i) two times the amount of annual compensation that can be taken into account under a tax-qualified plan under § 401(a)(17) of the I.R.C. ($245,000 for 2011; $490,000 when multiplied by two) for the year of separation, and (ii) two times the annual rate of pay for the employee at the time of separation, provided that, in either case, this portion of the severance amount is paid no later than the end of the second taxable year following the year in which separation occurs.[44] This is usually referred to as the involuntary termination exception. Further, in order to completely take the employee out of the realm of 409A, the employee's counsel can negotiate for the severance benefits to be paid within the "short-term deferral rule" discussed above.

In addition to these exceptions, there are numerous others for compensation and benefit arrangements that may be associated with separations.[45] The separation pay plans listed as excepted from deferred compensation status under § 409A include collectively bargained plans, a "window program,"[46] foreign separation payment plans, reimbursements of business expenses, specific tax-favored medical plans, certain in-kind and direct service benefits, indemnification plans and insurance policies protecting against certain liabilities, legal claim settlements in connection with employment-related claims, and certain educational benefits. Being aware of these exceptions can help the employee's counsel negotiate various severance arrangements for his or her client.

Termination of Employment: Release Requirement and § 409A Considerations

On Jan. 5, 2010, IRS released Notice 2010-6 that established a correction program for nonqualified deferred compensation plans that failed to comply with the documentation requirements under § 409A. Specifically, the Notice stated that since the timing of payments under certain nonqualified deferred compensation plans depends on actions of the employee, and the discretion the employee could exercise in regard to such action could affect the tax year in which the payment is made, allowing for such discretion is a violation of timing provisions under § 409A. The rules apply to payments triggered by any permissible payment event (e.g., a change in control) that are conditioned on an employment-related action by the employee, but would most often apply to separation from service when an employee has to sign a release in order to receive severance benefits. To comply with Notice 2010-6 and § 409A, any nonqualified deferred compensation plan (including employment and severance agreements) must be amended to remove employee discretion from the timing of when the employee could receive separation pay or other applicable deferred compensation.

While IRS Notice 2010-6 outlined procedures for removing the possibility of violations related to employee discretion in plan administration, the proposed correction program under the Notice was too restrictive. On Nov. 30, 2010, IRS released Notice 2010-80 slightly relaxing the rigid timing of the January 2010 Notice. According to Notice 2010-80, in the event of employee's separation from service, if a plan provides for payment subject to the employee's return of a release within a designated period, then the amended plan must provide for separation payment to be made either on the last day of such period or in the second taxable year, if the designated period begins in a first taxable year and ends in a second taxable year. If the plan does not provide for payment, subject to the employee's return of a release within a designated period, then the amended plan must provide for separation payment to be made either on the 60th or 90th day following the employee's separation from service or during a specified period not longer than 90 days following the separation from service, provided that if such period begins in one taxable year and ends in a second taxable year, the payment will be made in the second taxable year.

Practically, as discussed above, any new executive agreement will have to detail whether the payment is conditioned upon employee returning an executed and irrevocable release. The timing of the payment or the payment period will have to be specified according to the rules of IRS Notices 2010-6 or 2010-80. However, these timing restrictions apply only if the severance or other payments do not qualify for one of the exceptions to § 409A (e.g., the "separation pay exception" or the "short-term deferral exception"). If the payments are designed to satisfy one of the exceptions under § 409A, the agreement may require payment immediately after receipt of an effective release (following expiration of any statutory revocation period).

Termination by the Employer for Cause and Voluntary Resignation by Employee Without Good Reason

Generally, because an employee is not entitled to severance payments in the event of a termination for cause or a resignation by the employee without good reason, the compensation and benefits received by an employee are limited to those already earned and vested under applicable employer plans. Therefore, these provisions in the employment agreement should not create § 409A issues if the plans are compliant.

Severance Upon Termination Without Cause or Resignation With Good Reason

Under § 409A, a termination without cause is a "separation from service" and the receipt of "separation pay" by the employee is a permissible distribution.[47] Therefore, depending on the timing of payments, at least a portion of the severance payment should qualify for the involuntary termination exception described above or the exception provided by the "short-term deferral" rule. If the employee is (or reasonably likely to become) a "specified employee," a specific provision should be

[44] Treas. Reg. § 1.409A-1(b)(9)(iii).
[45] Treas. Reg. § 1.409A-1(b)(9).
[46] Treas. Reg. § 1.409A-1(b)(9)(vi).

[47] I.R.C. § 409A(a)(2)(A)(i).

included in the employment agreement that payments will be delayed under the six-month rule.

Section 409A permits a resignation by an employee for "good reason" to be treated as an involuntary termination. Under § 409A the question of whether a good reason definition will be satisfactory and fit within the involuntary termination requirement will depend on the specific facts and circumstances. Section 409A does provide a "safe harbor" definition of "good reason," listing a number of circumstances that may be included in a "good reason" definition that qualifies under the regulations. Any "good reason" clause that varies from the safe harbor definition must be defined carefully with the possibility that there is a risk that resignation with good reason under the agreement may not be treated as an involuntary termination under § 409A. In that event, the resignation with good reason under the agreement would not be allowed under the involuntary termination exception or the exception under the "short-term deferral" rule.

Six Month Delay for "Specified Employees of Public Companies"

In the event the employee is a "specified employee" under § 409A, any "separation pay" may have to be delayed for six months from the date of termination.[48] Under § 409A, a "specified employee" generally means a key employee who is an officer of a publicly traded company with annual compensation greater than $160,000.[49] It is important that an employment agreement for "specified employee" or a potential "specified employee" provides for the six months delay but also that the employee can get paid the amounts, if any, which would fit within the involuntary termination exception under § 409A before the expiration of the six month period.

Change in Control or a Change in Ownership or Control as a Distribution Event

Section 409A provides that "to the extent provided by the Secretary, a change in the ownership or effective control of the corporation, or in the ownership of a substantial portion of the assets of the corporation" constitutes a permissible distribution event.[50] Section 409A discusses in detail the meaning of a change in ownership or control for purposes of the regulation.[51] Therefore, a single-trigger[52] change of control provision should match or be narrower than the definition of a change in control under § 409A.

Assuming the employment agreement includes a compliant definition, it can provide for automatic acceleration of the severance payment (or any other deferred compensation or a change in control payment) upon the occurrence of a change in control, without violating the permissible distribution requirements or the six-month delay rule (because the payments are not made in connection with a separation from service). However, if the employment agreement provides that the employee can resign voluntarily during a specified period of time following the change in control and receive the same entitlement, this scenario would not fit within the § 409A severance exceptions discussed above and would need to comply with other § 409A distribution requirements.

Further, the employee could be entitled to a double trigger payment if the employee is terminated without cause or resigns with good reason within a specified time after the occurrence of a change in control. This would entitle the employee to enhanced severance payments under the agreement. These provisions should comply with § 409A's exceptions for involuntary termination or with the timing of payments and other distribution requirements of nonqualified deferred compensation under the regulation.

Post-Employment Obligations and Restrictive Covenants

Post-employment obligations and restrictive covenants appear in employment agreements, stock forfeiture plans, severance agreements and often, without an employee even noticing, on his or her desk along with hundreds of pieces of paper on the first day of employment. While volumes could be written about post-employment obligations and restrictive covenants, it is important to note that each state has its own standards about what kinds of restrictions are reasonable and enforceable.

Generally, restrictive covenants in the employment context are agreements between employers and employees that prevent employees from competing in the same or similar industry and geographic markets as the employer (noncompete provisions), sharing confidential or proprietary information outside of employment (confidentiality provisions), and "raiding" clients/customers and other employees of the former employer (nonsolicitation provisions) after employment ends. In most states, these restrictions must be voluntary, reasonable, and of specific duration in time and geography. To be reasonable, the restriction should be no greater than required "to protect the employer's legitimate business interests." While historically, these restrictions were

[48] I.R.C. § 409A(a)(2)(B)(i). Under § 409A, a termination due to death is not subject to the six months rule.

[49] *Id.* Under § 409A, a "specified employee" is a key employee (as defined in I.R.C § 416(i)) of a company whose stock is publicly traded on an established securities market. Under I.R.C. § 416(i) a key employee is an employee who is (i) an officer of the employer whose 2011 annual compensation is greater than $160,000 (the amount is subject to change from year to year due to cost of living), (ii) owns more than 5 percent of the employer or (iii) owns more than 1 percent of the employer with annual compensation in excess of $160,000. The number of employees that can be included as "key employees" because they are officers is limited to a maximum of 50 highest paid officers. If the corporation has 30 to 500 employees, maximum number of officers can be 10 percent of employees. If the employer has 30 or fewer employees, officers are limited to three employees.

[50] I.R.C. § 409A(a)(2)(A)(v).

[51] Treas. Reg. § 1.409A-3(i)(5).

[52] A single trigger provision generally permits an employee to resign for any reason once the change in control has occurred. A double trigger provision generally requires the employee to be terminated without cause or resign for good reason.

primarily reserved for the unique or highly talented employees or senior executives, in the current economic climate, where unemployment is a significant factor and employers have the upper hand, restrictive covenants are frequently imposed upon mid-level managers and even rank-and-file employees. Therefore, employee's counsel should pay close attention to these post-employment obligations.

Confidentiality and Trade Secrets Provisions

One common post-employment obligation concerns the prohibition of using or disclosing the former employer's confidential information and trade secrets. Usually, broad confidentiality and nondisclosure agreements or provisions in an employment agreement are not objectionable, because the employer's confidential information or trade secrets are protected under common law or by statute and apply regardless of whether they were specifically provided for in an employment agreement. What is most important is that the employee is aware of what constitutes confidential information or trade secrets and the steps the employee must take not to disclose such information during and after employment.

Further, confidentiality provisions should not be more burdensome than necessary. Any possible limitations or carve-outs to the definition of "confidential information" or "trade secrets" should be negotiated. For example, if an employee wants to bring his or her "rolodex" to the employer and exclude it from "confidential information," this should be stated in the employment agreement.

Noncompete Provisions

An employee's counsel's main concern and focus when negotiating restrictive covenants should be on noncompetition and nonsolicitation provisions. Generally, a noncompetition clause prevents an employee from working for a competitor of a former employer after leaving its employment. These provisions aim to limit the departing employee's activities and their choice of future employers. Under U.S. law, in most state jurisdictions, such a restraint on an individual's ability to find employment is disfavored and thus will only be enforced if reasonable where it protects the legitimate business interest of an employer, but imposes no undue burden on the employee.[53]

In negotiating these provisions, it is essential to analyze both the facts and the law. The factual analysis will include careful review of the provision, an in-depth investigation into the employee's position, duties, skills, and job experience, and research into the company's prior enforcement history, its current market position, and the relevant financial and geographic marketplace. Once the employee and the attorney have explored all of these factors, the relevant law should be analyzed and the employee's counsel should approach the employer about narrowing the noncompete to the specific need for the employer's protection and nothing broader. Employee's counsel should ensure that the covenants are reasonably related to the employee's role in the company, and his or her knowledge of confidential information and trade secrets.

Finally, keeping in mind the impact of the noncompetition provision on termination at the beginning of the employment relationship is advisable. Several state courts have ruled that a noncompetition provision is void in the event the employer materially breaches its employment agreement with the employee or the terms of employment or terminates the employee without cause.[54] Therefore, the employee's counsel may negotiate for a provision that, if the employment is terminated without cause or by the employee for good reason, then the noncompetition clause should not apply or should apply for a shorter period and be limited in scope. Further, the duration of the noncompetition period should be linked to severance pay or other consideration.

Nonsolicitation Provisions

Nonsolicitation clauses prohibit the solicitation of clients and/or customers, as well as the recruitment of co-workers from the former employer. Unlike noncompetition provisions that are generally disfavored by the courts, nonsolicitation or "anti-raiding clauses" will generally be upheld be they are often narrowly tailored to an employer's legitimate business interest.[55] In many states, the courts will uphold nonsolicitation agreements when they believe that it is reasonable for an employer to protect its investment in training its staff and maintaining a competent workforce.[56]

[53] *E.g., Campbell Soup Co. v. Desatnick*, 58 F. Supp. 2d 477, 488 (D.N.J. 1999) (internal citations and quotations omitted).

[54] Under New York law, an employer may not enforce a noncompete clause against an employee whose termination was "involuntary and without cause." *See Post v. Merrill Lynch, Pierce, Fenner & Smith, Inc*., 48 N.Y.2d 84 (N.Y. 1979). *See also Cornell v. T.V. Dev. Corp.*, 17 N.Y.2d 69, 75, 268 N.Y.S.2d 29, 34, 215 N.E.2d 349 (1966) (otherwise valid covenant against competition is unenforceable "when the party benefited was responsible for the breach of the contract containing the covenant"); *Bishop v. Lakeland Animal Hosp., P.C.*, 644 N.E.2d 33 (Ill. App. Ct. 1994) ("in order for a noncompetition clause to be enforceable . . . the employee must have been terminated for cause or by his own accord"). *See generally* Kenneth J. Vanko, *"You're Fired! And Don't Forget Your Non-Compete. . .": The Enforceability of Restrictive Covenants in Involuntary Discharge Cases*, 1 DEPAUL BUS. & COM. L.J. 1, 1 (2002).

[55] A nonsolicitation covenant will be rejected as overly broad if it seeks to bar the employee from soliciting or providing services to clients with whom the employee never acquired a relationship through his or her employment or if the covenant extends to personal clients recruited through the employee's independent efforts. *See Scott, Stackrow & Co., CPA's PC v. Savina*, 9 AD 3d 805 (2004); *Zinter Handling, Inc. v. Britton*, 46 AD 3d 998 (N.Y. 2007).

[56] *See Balasco v. Gulf Auto Holding, Inc.*, 707 So. 2d 858, 860 (Fla. Dist. Ct. App. 1998) (noting importance of workforce stability); *Natsource LLC v. Paribello*, 151 F. Supp. 2d 465 (S.D.N.Y. 2001); *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Ran*, 67 F. Supp. 2d 764, 774 (E.D. Mich. 1999) (upholding as reasonable a one-year customer "anti-piracy" clause); *see also* Kenneth J. Vanko, *"You're Fired! And Don't Forget Your Non-Com-*

Counsel negotiating these restrictions for employees should ensure that they are as narrow as possible and do not inadvertently turn into a noncompetition provision by virtue of their broadness. It is important to demand that the nonsolicitation provision only cover the clients or employees that the employee became acquainted with, worked directly with, or serviced during employment and does not apply to all clients or employees of the employer. In addition, the nonsolicitation clause should exclude clients or colleagues that worked with the employee prior to commencement of employment so that the employee is not prohibited from reaching out to his or her prior contacts in the market. Finally, it may be important to negotiate that the provisions do not include a no-hire clause if this is an issue for the employee.

Restrictive Covenants in Equity Compensation Plans

A current trend for employers is to include restrictive covenants in equity compensation plans or agreements signed by employees upon the grant of equity or options. If the employee is granted equity at the inception of the employment relationship, it is important that counsel review all of the documents the employee will be signing, including stock grant or stock option agreements. The breach of post-employment restrictions found in equity agreements may entitle the employer to an injunction or require the employee to return (or forfeit) the equity he or she earned or was paid as a result of the breach.

Indemnification and Directors and Officers Insurance

Depending on the company and the type of business the employee will be working for, it may be prudent to ask for indemnification for claims threatened or filed against the employee stemming from his or her status or activities. Often, executives are indemnified in the corporate documents or by-laws or the company may purchase specific officers' and directors' liability insurance for them. In either case, it is important to review the indemnification provisions to make sure that maximum coverage is provided.

Excise Tax Gross-Up

If the employee has a change in control provision in his or her employment agreement that would trigger payment upon the occurrence of a change in control, the employee's attorney should negotiate for a tax gross up provision that would make the employee whole in the event excise or penalty taxes are imposed on the employee because of the "parachute payments"[57] triggered by the change in control. Counsel should be aware of I.R.C. §§ 280G and 4999 and their application and advise the employee to seek proper tax advice related to these issues. Likewise, if an employee is a "specified employee" under § 409A or other terms of the agreement may violate § 409A, the employment agreement should provide for a gross up in the event the employee is penalized for any violations of § 409A.

Dispute Resolution and Choice of Law/Jurisdiction Provisions

An employment agreement should include a dispute resolution provision setting forth what forum will address any disputes that may arise under the agreement. Arbitration has many advantages for employees, including speed, cost, and finality. The employee's attorney should suggest such an arbitration provision if is not already in the agreement. However, arbitration should be limited to contract claims and discrimination and statutory claims should be carved out from the arbitration process.

Negotiating a three step resolution process is recommended. This should include: (1) a good faith discussion of the dispute for a reasonable but short period; (2) mediation using an agreed upon mediator or mediation provider; and (3) arbitration using a well respected arbitration provider. The parties may agree to engage in the first two steps once the dispute has arisen, but including such a provision in the agreement may help initiate discussion and possible early resolution. The dispute resolution provisions should also address the location where the mediation or arbitration would take place and the employee's attorney should negotiate for the location to be near the employee's workplace or home to avoid unnecessary expenses.

The cost of the mediation and/or arbitration and attorney's fees should be addressed. The employee's counsel should negotiate for the employer to cover these costs. At the very least, the employee's counsel should insist that if there is litigation under the agreement, the court or the arbitrator should have the authority to award attorneys' fees and expenses to the prevailing party.

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pete. . .": The Enforceability of Restrictive Covenants in Involuntary Discharge Cases, 1 DEPAUL BUS. & COM. L.J. 1, 1 (2002); Kristin Henry, *Black & Decker to Pay Brotman $235,000—Court of Appeals Declines to Take Up Long Legal Battle*, BALT. SUN, Feb. 15, 2002, at 11C. *Prudential Wins Court Bid to Bar Hirings*, N.Y. TIMES, Mar. 16, 2000, at C14 (leader of Prudential Securities' asset-backed securities group and eight other executives, who together accounted for more than ninety percent of the revenue generated by the asset-backed securities group, resigned and joined Credit Suisse First Boston. Prudential brought suit against the executives and their new employer to enforce the nonsolicitation agreements. Prudential won a temporary restraining order and monetary damages from Credit Suisse and the executives).

[57] I.R.C. § 280G makes nondeductible for the employer any "excess parachute payment" paid to the employee. I.R.C. § 4999 imposes a 20 percent nondeductible excise tax on the employee for receipt of any "excess parachute payment." A "parachute payment" is a payment contingent on a change in control where the sum of all payments contingent on the change in control equals or exceeds three times the disqualified individual's "base amount." "Base amount" is average W-2 compensation over five years preceding year in which change in control occurs. I.R.C. §§ 280G(b)(3)(A) and (d)(1) and (2) . An "excess parachute payment," the amount subject to I.R.C. §§ 280G and 4999, is the excess of the amount of any parachute payment over the individual's base amount.

Finally, every employment agreement should have a provision binding the parties to a specific choice of law that will be applied to a dispute and jurisdiction where the dispute would be filed. In determining the choice of law and jurisdiction for the agreement, it is essential to look ahead to the end of the relationship and consider the enforceability of certain provisions, such as restrictive covenants, notice provisions, or even the termination provision itself, after the employment ends. Typically, if the employee is not located in the same state as the company or the company's headquarters, the state where the employee works is the preferred choice for jurisdiction to avoid the expense of out of town travel and the unavailability of important witnesses for the employee.

Miscellaneous

Boilerplate provisions at the end of employment agreements typically address some of the following subjects: remedies (including availability of injunctive relief and liquidated damages), successors and assigns (binding and benefiting successors of both employer and employee), integration and merger, severability, and survival of certain rights. If possible, the employee or his or her attorney should ensure that the company covers the employee's attorneys fees incurred in negotiation of the employment agreement.

Conclusion

The new regulations implementing Dodd-Frank, which various agencies are rolling out, will play out against the needs of an increasingly mobile workforce faced with corporate sustainability issues, decreasing shareholder value, and economic instability. Against this backdrop, negotiating and drafting reasonable and balanced executive agreements are challenging, particularly in today's difficult and unstable economic times. Shareholders of public companies are proactively (and in light of recent regulations) advocating severe restrictions on executive compensation. Since statutory requirements—through clawbacks and other offsets—are forcing executives and other employees to personally take on what was once solely considered corporate risk, many executives will no longer enjoy advantages they once had. In fact, there is already a recognition that the old rules of recruiting and retaining executive talent through cash compensation are over. Although many key terms in an agreement will likely remain the same, regulatory, tax, and financial risk issues will impact how much negotiation can actually be achieved. Already, there is a clear shift away from "golden parachutes" and rich severance and equity packages to performance-based compensation and long-term bonus and equity deferrals with no acceleration and a burdensome host of restrictions. Undoubtedly, companies and board compensation committees will be hard pressed to garner top talent and will be faced with the challenge of creating new compensation structures and re-thinking old methodologies for rewarding performance and maintaining employee loyalty and longevity.