



**Lowenstein Sandler's Employee Benefits & Executive Compensation Podcast:
Just Compensation**

**Episode 16
Sign on the Dotted Line: Negotiating an Effective
Employment Agreement**

By [James Gregory](#), [Batool Banker](#), [Taryn Cannataro](#)

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Taryn Cannataro: Welcome to the latest edition of Just Compensation. I'm Taryn Cannataro, an associate in Lowenstein's Employee Benefits and Executive Compensation Group. I'm joined today by Jim and Batool, who I will turn it over to introduce themselves.

Batool Banker: Thanks, Taryn. As Taryn mentioned, I'm Batool Banker, also an associate in the Executive Compensation and Employee Benefits Group at Lowenstein Sandler.

James Gregory: Hi there, Batool and Taryn. This is Jim Gregory. I'm a partner in the Executive Compensation practice based here in Lowenstein's New York office. So thank you very much.

Taryn Cannataro: Today's topic is one that commonly affects individuals who are seeking new employment, who are looking to update the terms of their existing employment arrangement with their current employer, or whose employer may be undergoing a sale or investment transaction, that is executive employment agreements.

While the negotiations surrounding executive employment agreements often focus on compensation, other ancillary terms can be just as important. In this podcast, we will discuss some of the terms that are often negotiated when companies and executives are considering entering into a new executive employment agreement. We will be highlighting certain points that may be important from the perspective of each the employee and the employer.

Let's start from the beginning. Is a fulsome employment agreement necessary for all employees? And if not, why would an employer or an employee want one?

James Gregory: Great question, Taryn. Generally speaking, employment in the United States is at will, which means the company and the executive can terminate the employment relationship at any time, for any reason, or for no reason. However, companies often want assurances they will be able to retain an executive for a certain period of time. And some employees, mostly senior executives, will expect or even demand severance or other protections in an employment agreement in order for them to take the job.

Although many employment agreements are for an infinite duration, kind of open-ended, a company can propose a specific term of employment. We typically see this

term range anywhere from maybe one to five years, three years is probably a little more common, but this term can be for any length of time. This means that the executive generally agrees to remain employed with the company for that period, whatever it is, although, of course, they can often terminate sooner under specific circumstances. And at the end of the specified term, the employee and the executive can renew the agreement, or sometimes the agreement automatically renews unless either party decides otherwise by giving notice.

Regardless of the agreed-upon employment term, the agreements almost always expressly say that they will automatically terminate upon death or permanent disability, which is usually a defined term. And the companies are almost always going to have the ability to terminate earlier for cause. And cause is defined. And often, that is one of the most heavily negotiated terms of an employment agreement.

Batool Banker: Definitely, Jim. And from the executive's perspective, an employment agreement with a stated employment term can also give the executive some comfort that the company intends to retain them for a certain period of time, especially when the negotiation is in connection with a sale of a company or investment where ownership of the company may be changing.

As Jim mentioned, if an executive is contemplating entering into an employment agreement for a specific term, they may want to ensure that they'll also be able to terminate their employment under specific circumstances. For example, a resignation for good reason. And also, the exec may want to ensure that if the company does terminate their employment earlier than the end of the stated term, the executive will be entitled to severance benefits. We will discuss both of these concepts later in the episode.

Taryn Cannataro: Aside from the employment term point, it's helpful for both the executive and the company to have a fulsome, tightly drafted employment contract with all the bells and whistles, wouldn't you both agree?

Batool Banker: Yes. Yes, I'd agree. A fulsome employment agreement is helpful for both parties to avoid ambiguity in the employment relationship. It's also helpful in the unfortunate event there's any disagreement over the terms of employment, especially in states that may be particularly employer or employee-friendly in the absence of a written agreement.

Additionally, an executive may want to ensure that any exit terms, for example a severance, are determined prior to the time of a termination. Since this is the time when the executive may have more leverage in the negotiation, overall it's important to have agreements that address these issues from the outset of employment.

Taryn Cannataro: Great. Thanks, Batool. Let's move on to a topic that everybody's usually most concerned with, compensation. Aside from the standard base salary, what are some other key components of compensation that are typically negotiated within an executive employment agreement?

Batool Banker: Sure. Well, starting with compensation, for the executive it's important to make sure not only that the agreement clearly states the amount of annual- based salary and annual target bonus that the executive will be eligible to receive each year, but also the process and frequency of which these amounts will be reviewed for increase in the future. One provision we typically like to see when representing an executive is that base salary and annual bonus will be reviewed at least annually for increase, but not for decrease.

James Gregory:

So taking the employer's side of the negotiation here, Batool. If that no decrease language is acceptable, one caveat that the company might want to consider is to allow it to decrease the compensation in the event of a company downturn or a decrease across the board or for similarly situated executives, which could help protect the company in the event of any unforeseen financial issues like a downturn in the business.

These across-the-board reductions were actually quite common during COVID. And having these provisions baked into your executive employment agreements for the company means that the company doesn't have to go back to each individual executive and get their specific consent at the time they want to make a reduction which may or may not be an issue. And again, representing the company, it's much easier to get that agreement up front when someone is joining the company because they want to be viewed as a team player and not someone that's going to hold up that kind of a change if necessary for the business.

Also, although many executives are going to want the contract to clearly state the amount of their bonus opportunity with some specificity, from the company's perspective it's important to provide that the amount of the bonus and ultimately whether the performance targets are met, for example, are going to be determined in the company's discretion. This is important not only because the company is going to want to reserve to itself the ability to make the ultimate decision, but also if you make a bonus payment too formulaic and nondiscretionary, you can implicate state wage law claims.

For example, in New York state, if a company fails to pay a bonus that's not discretionary or as formulaic, the employee can actually go to court and not only get the bonus but arguably punitive damages and even attorney fees. So it's a pretty significant liability for the employer if they don't make the bonus discretionary.

Batool Banker:

Such a good point, Jim. I'd argue that while bonuses are generally discretionary, the executive can still request that a target bonus range be set, for example a certain percentage of their base salary, or could even request that the first year's bonus be a guaranteed amount, especially if the executive is forgoing a bonus at their prior employer.

Another major component of compensation for executives can come from equity. While typically the actual equity grant occurs after commencement of employment and involves separate grant agreements or equity plans, it may be helpful for executives to request that the terms and conditions of the proposed equity grant are detailed with as much specificity as possible in their employment agreement, and possibly even request that any proposed grant agreements or equity plans are incorporated as part of that agreement.

James Gregory:

I agree with all of that, Batool. And companies, of course, are going to differ as to what they offer and how much they offer as far as equity goes to employees based on a number of factors, such as the seniority or the position of the executive, what stage of life the company is in. Whether it's a private or a public company, for example, has a big impact on what kinds of equity are offered.

For example, an early-stage startup company with less cash on hand may offer significantly more equity as a component of total compensation in exchange for a lower-based salary. The idea is that the company is preserving cash for future growth, or maybe it doesn't have cash, whereas they have plenty of equity and are willing to give that equity out to employees who view it as sort of a classic trade, more risk but much more upside versus maybe what they would experience at a more established company or a public company.

Batool Banker: That's true. And Taryn, to your earlier question, while cash compensation and equity are certainly major incentives, executives can get creative when negotiating benefits. For example, requesting certain travel accommodations, flexible work arrangements, especially in this COVID remote environment, or even wardrobe or makeup budget, depending on the industry. The types of benefits we see executives request varies. What may be important to one executive may not matter to another. But you should also note that non- cash perks are out of favor at many public companies, especially for the most senior executives whose compensation, benefits, and perks are subject to public disclosure.

Taryn Cannataro: You each mentioned severance earlier. Is it common to negotiate severance terms along with an employment agreement before employment even begins?

James Gregory: Absolutely, Taryn. In fact, I would say that the severance provisions of an employment agreement are probably viewed by both parties as the most important provisions, or certainly among the top provisions. You should really think of an employment agreement as sort of a prenup which provides a roadmap for what'll happen if things don't work out.

Obviously, a termination of employment in this example or analogy would be similar to getting a divorce. You go into a marriage or into employment hoping that it's going to work out and hopefully not expecting a divorce or a termination of employment, but you have to plan for it. And that's really what the employment agreement does. It is important for the company that the parties understand exactly what the executive will be eligible to receive in the event of a termination of employment to preempt any disagreements at the time of separation, especially if the separation becomes contentious.

Severance is often a payment based on a portion of base salary. For example, we typically see maybe six months to one year of base salary for a private company, but it could be longer or a larger amount for senior executives or executives at public companies. There may also be a bonus component and continued health benefits or COBRA continuation payments. From a company perspective, severance should be reserved for instances where the individual is terminated by the company without cause or possibly for good reason. In other words, only on an involuntary termination. No one should get severance because they simply quit for no reason.

Batool Banker: That's a fair point, Jim. We mentioned cause and good reason earlier, and from an executive's perspective, severance payable upon a good reason resignation is key. And whether to include good reason termination rights and how good reason is defined can be a heavily negotiated point. The good reason concept is the converse of cause. It allows an executive to terminate their employment due to the company's breach of the employment agreement or other adverse conduct. Essentially, good reason is meant for situations where these material adverse changes result in a constructive dismissal of the executive, meaning the company's actions have effectively terminated the exec's employment.

Examples of a good reason termination might include the executive's decrease in salary or title, a change in the exec's reporting structure to where they are effectively demoted, or the executive being required to relocate their principal place of employment. Good reason is typically reserved for the most senior executives.

And as Jim said earlier, while severance is usually a payment tied to base salary, executives can also request that they be provided with all or a pro rata portion of their expected bonus for the year of termination, payment to cover the cost of continuing healthcare premiums, or even accelerated vesting of all or some portion of the unvested equity they hold at the time of termination. Also, if the executive is being

asked to agree to a post-termination non-compete which could limit their marketability moving forward, they may request that the severance is paid alongside the length of the post-termination covenant. So they continue to receive payments while they are kept out of the market.

James Gregory: And whether and what to offer as severance often depends on the executive's seniority and title. Regardless, though, of what they are receiving as severance, from a company's perspective it's essential to require that any severance payments be conditioned upon the execution of a release, a general release of claims in favor of the company and its subsidiaries and affiliates.

Taryn Cannataro: Speaking of the release of claims, should this agreement be negotiated at the same time as the employment agreement?

James Gregory: Well, in my experience, many companies prefer to require that the release be in a form and substance acceptable to the company in its sole discretion at the time of the termination. This allows the company the flexibility to not only update the release for any changes in law, but also to draft the release in a way that is deemed most protective of the company at the time of the termination. And honestly, the company has, I think, a little more leverage at that point in time than they do sometimes at the beginning of the employment relationship.

Batool Banker: Whereas from the executive's point of view, it's usually better to have the release negotiated along with and attached to the employment agreement so there are no questions as to what the executive will have to sign in order to receive a severance. This is often a negotiated point between the two parties. And side note, release language is almost always unilateral, which means only the company is released from potential claims by the employee. Although employers typically won't agree to accept a mutual release in the employment agreement, they might agree to a mutual release as part of the separation agreement at the time of termination, assuming they are comfortable that they have no claims against the executive at that time.

Taryn Cannataro: You mentioned restrictive covenants earlier, which are a standard and important feature of all executive employment agreements. Can you talk to us about what type of restrictive covenants are commonly negotiated?

James Gregory: Sure. Some of the most common and important restrictive covenants, again from the company's perspective, are confidentiality obligations, intellectual property-related covenants, and non-disparagement obligations, which prevent the executive from disparaging or speaking negatively about the company post-employment. These provisions can be pretty standard and are, in my experience, not really highly negotiated.

But where we see a lot of attention paid in the negotiation process is in respect of the non-compete and non-solicit covenants. Post-termination non-compete and non-solicit obligations are often critically important to a company, especially when the executive is very senior, as they limit the executive from providing services to a business that may be competitive with the company or from poaching current employees or customers of the company for a set period of time after they leave the company. The duration and scope of a non-compete and non-solicit must be reasonable, which is defined under the applicable state law. You'll find, however, that what is reasonable will vary greatly based on the facts and circumstances of the specific employee and employer and state law. And several states have enacted legislation to curb these post-employment restrictions.

Batool Banker: As Jim said, several states impose restrictions on post-termination non-competes and non-solicits. The most prominent example being California. If an executive is asked to

agree to post-termination non-competition or non-solicitation obligations, they should make sure that the proposed terms comply with applicable state law and are narrowly tailored to allow the executive to seek meaningful employment after they leave the company. If an executive is engaged in any outside business or charitable activities, for example a board position, it would also be helpful to carve those out from any restrictive covenants from the outset of employment.

Another executive-friendly point that we often see is requesting that any non-disparagement obligations are mutual so that the company cannot disparage or speak negatively about the executive after they part ways.

James Gregory: Batool, I would add just one caveat to that point, which is that a well-advised employer usually won't agree to a "company" non-disparagement because they can't effectively control what is said by their entire employee base, both internally and externally. So instead, the employer might agree to instruct certain named executives or board members not to disparage the former employee to third parties, et cetera. But again, in my experience, I don't think a company is typically going to agree to sort of a flat non-disparagement provision. But it's often asked. They are certainly requested by the executive's counsel.

Batool Banker: Sure. And it definitely does not hurt to ask, Jim.

James Gregory: I agree.

Taryn Cannataro: You both have made some great points. Are there any other important considerations or items that we haven't discussed yet?

Batool Banker: Well, generally speaking, a negotiation between a company and an executive is just the starting point of what will hopefully be a long and fruitful employment agreement. As Jim said, this is hopefully going to be a long marriage. That being said, it's important for the process to remain cordial. An aggressive argument upfront could lead to a strained working relationship from the outset. For this reason, retaining counsel to address any potentially contentious matters is often a best practice for both parties to get the terms they want. And it helps maintain goodwill for the future employment relationship.

James Gregory: I agree 100%, Batool. An overly aggressive attorney for a new hire, or for that matter inexperienced in-house counsel can stall or frustrate a negotiation. It can also be awkward for the in-house legal team to handle the negotiation for a very senior new executive who they may end up reporting to, which is another reason for the company to retain outside counsel.

In any event, by the time we usually get involved, the basic business terms are already agreed to and the mandate for us is simply to resolve any open issues, paper the agreement, and finalize the hiring in a cooperative and collegial manner. And we are able to successfully achieve this in the overwhelming majority of cases.

Taryn Cannataro: Thank you so much for joining us today. We hope this episode provided some helpful guidance in the event you find yourself negotiating an executive employment agreement, either from the company or an executive's perspective.

As always, today's discussion was intended to be a general, high-level overview of a few considerations to be mindful of and was by no means a comprehensive list. The facts and circumstances of every executive employment agreement will differ. If you find yourself in a position where you will be negotiating a new executive employment agreement, we recommend you consult counsel.

Thank you so much Batool and Jim for joining us today. We look forward to having you back for our next episode of Just Compensation.

Batool Banker: Thank you, Taryn.

James Gregory: Thank you very much, Taryn.

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