3 Aspects Of Executive Agreements That Need An Upgrade

By Zak Franklin

Law360 (February 13, 2019, 5:03 PM EST) --
Executives are no longer reluctant to lawyer up. News reports on executive/employer contretemps at Papa John's, Barnes & Noble, Uber and other companies have drawn press attention in the past year; countless other executive/employer disputes have flown below radar.


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Underlying these controversies is the executive's employment agreement, typically the most high-stakes and closely negotiated employment agreements to which companies will contract. Yet, these agreements often contain less clarity and less certainty than either executives or their employers need.

From the perspective of an employment lawyer sometimes asked to review a contract by a terminated executive and sometimes asked to do the same by a disappointed employer, there appear to be three areas where these contracts could and should be upgraded. The first is in the definition of "cause"; the second is in specifying performance-based compensation metrics; and the third is in boilerplate that has evaded updating. Let's look at each in turn.

1. "Cause" for Termination

Executive employment agreements routinely limit post-employment benefits based on termination for "cause." Each organization should have its preferred definition of "cause" for its executives. Take for example, this revised definition of "cause":

- Conviction of, or a plea of guilty or no contest to, a felony arising from any act of fraud, embezzlement, or willful dishonesty in relation to the employer's business or affairs.

- Conviction of, or a plea of guilty or no contest to, any other felony or any other criminal charge which is materially injurious to the employer or its reputation or which compromises the executive's ability to perform employment duties and/or to act as a

representative of the employer.

- Willful failure to attempt to substantially perform employment duties.

- Material violation of the employer's written policies relating to sexual harassment, business conduct, or other material employer policies.

- Material breach of the terms of the employment agreement or breach of the employee covenants agreement.

- Failure to materially cooperate with, or impeding an investigation authorized by, the board.

This appears comprehensive and tight but only on the surface. Terms like “materially,” “substantially perform” and “in relation to” are undefined and, thus, debatable. Such language is one reason why a terminated executive can make a legal claim in arbitration for his promised post-employment compensation of several million dollars despite substantial proof of violations of company policies on harassment.

Perhaps, this ambiguity is desirable: a mutual decision to “kick that can down the road” and debate later what percentage of the promised compensation will be paid in settlement based on the significance of the evidence of executive failures. If so, this language is perfect. If something closer to predictability is desired, there are better ways to draft and define “cause,” as this alternative illustrates:

> The Company may terminate Executive’s employment during the Employment Period either with or without Cause. For purposes of this Agreement, “Cause” shall mean Executive’s: (i) unauthorized use or disclosure of Confidential Information (as defined below); (ii) material breach of this Agreement or any other material written agreement between Executive and the Company; (iii) failure to comply in all material respects with the Company’s written policies or rules, including its Code of Conduct; (iv) conviction of, or plea of guilty or no contest to, a felony or other crime involving moral turpitude; (v) commission of an act involving misappropriation or fraud; (vi) gross negligence or willful misconduct; willful failure to perform assigned duties or responsibilities; or (vii) failure to cooperate in good faith with a governmental or internal investigation of the Company or its directors, officer or employees, if the

> Company has requested such cooperation. Except in the case of the reasons listed in clauses (iv) and (v) of this Section 3(b), Cause shall only exist if, to the extent that such condition is capable of being cured, (A) the Company provides Executive with written notice of the existence of the condition that forms the basis for Cause with 30 days of the Reporting Officer acquiring knowledge of such condition, and (B) Executive does not cure such condition with 30 days following the delivery of such notice.

Better, but still not ironclad. The point is that all cause definitions are not created equal and that the choice has subsequent consequences which need to be considered when executives are hired. Boards often operate with a common-sense definition of “cause” and are shocked to see claims from former executives who seem to have clearly violated company policies.

2. Performance-Based Compensation Metrics

Compensation terms are key but too often unclear, creating issues on how to interpret performance-based compensation metrics. To minimize disputes, executive employment agreements should employ defined terms and use objective criteria to determine performance-based compensation.

Using undefined terms can be problematic. For example, “salary” is easy; it is a term with a legal history and is carefully defined in regulations issued under the Fair Labor Standards Act. Conversely, “target bonus” is not a term with any legal history and is, moreover, used in different ways in different organizations. Here, and elsewhere (e.g., vesting of equity grants), defined terms are essential to ensure that both parties are speaking the same language.

Likewise, using objective criteria to determine the amount of compensation adds certainty. Objective criteria (e.g., change in stock price, gross revenue, growth), however, are valuable only if clearly stated. Consider the following example with net sales growth and earnings before interest, tax, depreciation and amortization:

> Executive will be eligible to receive an annual bonus (the “Annual Bonus”), with a target opportunity equal to 40% of Annual Base Salary and a maximum opportunity equal to 80% of Annual Base Salary. For the 2020 fiscal year, the Annual Bonus will

be based (A) 50% on net sales growth targets and (B) 50% on EBITDA growth targets, in each case, as set forth below:

	Target (50% Payout)	Maximum (100% Payout)	(200% Payout)
Net Sales Growth	20%	25%	30%
EBITDA Growth	30%	50%	70%

If you are struggling, you are not alone. Objective criteria: yes. Clarity: no. Perhaps, the advice should be this: Use objective criteria that are stated clearly and in a way that can be readily understood.

3. Out-Of-Date Boilerplate

Executive employment contracts often contain boilerplate language mined from previous agreements. Yet, such language may no longer sync with developments in the law. What was lawful once may no longer be and what is enforceable in one jurisdiction or for one employee may be unenforceable in other contexts. Executives prefer bespoke tailoring; their contracts should likewise be customized.

Common examples of such inapposite boilerplate include:

- ***Restrictive Covenants:*** In California, almost all restrictive covenants are unenforceable; in many other states, there are a sequence of limitations (e.g., Massachusetts' new statute requiring compensation during the restriction). Your CEO deserves better than off-the-rack suits or restrictive covenants.

- ***Disability as a Basis for Termination:*** Prior to 1990 (when the Americans With Disabilities Act come into play), executive contracts terminated with the executive's "death or disability." Now, that is disability discrimination. So too is the patch that termination will occur "after 180 days of consecutive disability"; the U.S. Equal Employment Opportunity Commission will not accept any automatic ceiling to an employer's duty to accommodate disability.

- ***Mandatory Arbitration:*** Appearances that the U.S. Supreme Court had endorsed employment arbitration for everything may be deceiving. There are exceptions which should be addressed (perhaps with the following caveat: “all claims between X and ABC Company shall be arbitrated except as required by law”).

That is easier than a longer litany which might look like this:

> Claims excluded from mandatory arbitration under the Policy are (i) Workers’ Compensation benefit claims (but workers’ compensation discrimination and/or retaliation claims are covered); (ii) state unemployment or disability insurance compensation claims; (iii) claims for severance benefits under ABC Company’s Severance Pay Plan; (iv) claims for benefits under ABC Company’s other ERISA benefit plans; (v) claims for benefits under ABC Company’s Short-Term Disability Plan; (vi) claims that may not be the subject of a mandatory arbitration agreement as provided by Section 8116 of the Department of Defense ("DoD") Appropriations Act for Fiscal Year 2010 (Pub. L. 111-118), Section 8102 of the Department of Defense ("DoD") Appropriations Act for Fiscal Year 2011 (Pub. L. 112-10, Division A), and their implementing regulations, or any successor DoD appropriations act addressing the arbitrability of claims; and (vii) claims that the Dodd-Frank Wall Street Reform and Consumer Protection Act or other controlling federal law bars from the coverage of mandatory pre-dispute arbitration agreements.

Yet, even that list now needs updating in New York. There, pending challenges that such state laws are preempted by the Federal Arbitration Act, employers may no longer compel claims alleging sexual harassment into arbitration, even if the arbitration clause is otherwise enforceable.

Conclusion

Charles Stross, a British science fiction author, offered a helpful assessment: "Contract law is essentially a defensive scorched-earth battleground where the constant question is, ‘if my business partner was possessed by a brain-eating monster from beyond spacetime tomorrow, what is the worst thing that they could do to me?'"

Isn’t it time to ask that type of question about executive employment agreements?

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