

GUIDELINES FOR EXECUTIVE EMPLOYMENT CONTRACTS

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The following is intended as a thought-provoking guideline for executives contemplating entering into an employment relationship. It does not constitute legal advice and a prospective employee should seek the advice of an attorney with regard to the drafting of any specific agreement.

Introduction

Employment agreements or contracts are useful in clarifying each party's expectations regarding an employment relationship and to minimize the risk of disputes during or after the creation of that relationship. Such agreements imply the expectation of a long-term association and a professional approach by both employer and applicant to governance and management. An agreement which demonstrates corporate commitment leaves an executive free to focus on doing his or her job. An agreement or contract is preferable to an offer letter because, typically, an offer letter does not provide the same level of security to an executive as would a contract or agreement. Even if an offer letter establishes a contractual commitment, it usually does not establish clear structure regarding compensation and vesting schedules, and/or provisions in the event of a change in control, etc.

Employment agreements also graft rights and duties onto an employment relationship which are not otherwise provided by Florida law. In addition, every contract is governed by an implied covenant of good faith and fair dealing, by which each party covenants not to interfere with rights and benefits that flow to the other party under the contract.

Employment agreements are a product of negotiation. A prospective executive's negotiation should be for greater reward, greater responsibilities, risk reduction (severance in the event of discharge, promises of promotion), and security in the event of acquisitions or mergers. Like any contract, the final agreement requires offer, acceptance and consideration. In addition, to be enforceable in Florida, the agreement must specify the term or duration of the employment relationship being established.

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1. Term of Employment

In the absence of a contractual agreement providing a starting and ending date for the employment relationship, employees in Florida are considered to be employed “at-will,” and to serve at the pleasure of the employer. The employment of an “at will” employee can be terminated at any time for any legal reason or no reason at all. Therefore, be sure that any agreement specifies the starting and ending date of the employment. A contract may provide for “automatic” term-to-term renewals, with the proviso that such a provision may make it unlikely that the company will subsequently be motivated to renegotiate resulting in greater compensation.

2. Duties and Authority

The contract or agreement should specify the title for the position, and duties and authority to be exercised by the executive, such as will be commensurate with that title. Even though a description in broad terms permits flexibility, the agreement should specify the executive’s major duties and a standard for performance. The method and individuals responsible for measuring performance should also be specified. Corporate documents which provide guidance should be incorporated by reference.

3. Compensation and Benefits

a. Compensation:

Executive compensation may be current or deferred, but it will probably include at least some component which is at a fixed annual rate. An agreement should provide for the frequency of payment, as well as a schedule and criteria for increases. If the bulk of compensation is fixed, the parties should consider incorporating provisions for projected inflation through a cost-of-living escalation clause, an automatic basic salary increase clause or a schedule for profit-sharing. Compensation should be structured to minimize tax consequences.

b. Benefits:

The agreement should clearly describe all the benefits to which the executive will be entitled during employment, including director and officer liability insurance, health insurance and continuation in the event of separation [COBRA], major medical insurance, and dental insurance. The agreement may provide for a waiver of waiting periods for benefit entitlements. Any number of other agreed benefits should be addressed as well, such as life insurance; disability insurance and payments in the event of total or partial disability; pension and profit-sharing plan participation; entertainment and/or automobile allowances (with or without documentation) and/or a car; club and society membership dues; reimbursed continuing education; paid sick leave; amount of paid vacation together with increases based upon longevity and whether it may be deferred from year to year or unused vacation may be redeemed for compensation;

incentive compensation; reimbursement of relocation expenses; expense reimbursements, etc.

c. Stock options:

The key features of a stock option agreement should be set out in the employment agreement but a detailed stock-option or stock purchase agreement, signed by both parties, should also be incorporated as an attachment. If possible, incorporate a provision establishing a right to exercise options even in the event of a termination for “cause.”

Prior to reaching agreement, make an effort to understand the key documents of the company’s plan, such as the Stockholder’s Agreement, Company Bylaws, Equity Incentive Plan, the Grant Letter, Stock Option Agreement and Notice of Exercise. Some of these affect your ability to sell shares or require you that you sell only under certain circumstances. Rights of first refusal and other rights of repurchase may affect your subsequent cash flow and option wealth. Once you are familiar with these documents, you may be able to negotiate an employment agreement which neutralizes the effects of provisions which are unfavorable to you. The number of shares is a critical term in a negotiation. Find out what share of the company the options actually represent. An executive who negotiates for a fixed percentage of the company rather than a specific number of options may avoid dilution of ownership interest. With a new company, an executive might also negotiate for monetary compensation in case an anticipated stock option plan never materializes, which compensation would increase on each anniversary of employment.

Some stock option plans allow executives to accelerate vesting if a resignation or severance is related to an acquisition, change in salary, title or work location.

An early exercise term for all or part of the option, including the nonvested portion, is acceptable to some employers in exchange for recruiting a highly-desirable executive. An employer might be motivated by considering that such a term could provide an executive incentive toward increasing the value of stock, however, the executive may also need to accept a restriction such as would ensure his or her employer of a long-term commitment.

4. Separation or Termination of the Agreement

Any number of permutations can result in termination of the agreement by either the employer or the executive. They should all be subject to notice requirements in a specific form and for a definite period in advance of termination. A termination for cause should be preceded by a notice giving an opportunity to cure or refute the allegations, a statement of cause and documentation. If the parties agree on an opportunity to refute “cause” then some procedure for a “hearing” should be specified.

With respect to all events culminating in termination of the agreement, the agreement should make it clear exactly when the work obligation ends, when

compensation and benefits cease, whose right it is to give public notice of termination as may be required, and any continuing duties and/or obligations. The agreement should address the rights and/or obligations of the parties following termination including provisions for return of equipment, keys, or other property.

a. Termination for Cause & its Consequences:

Behavior or circumstances which might justify termination for cause by the employer should be exclusively listed in the contract. Examples would be: theft or embezzlement by the executive with respect to the employer; malfeasance or gross negligence in the performance of the executive's duties; commission by the executive of a felony or crime involving moral turpitude (vague); willful or prolonged absence from work by the executive (other than by reason of disability due to physical or mental illness) or intentional failure, neglect or refusal to perform duties and responsibilities without the same being corrected within ten days after receiving written notice thereof; the continued or habitual use of alcohol to an extent materially impairing the executive's performance of his duties without the same being corrected within ten days after receiving written notice thereof; use of illegal drugs without the same being corrected within ten days after being given written notice thereof; or material breach of any covenant in the agreement.

The contract may provide that in the event of termination for cause that the executive is still entitled to specific items delineated in the agreement, such as payment of unused vacation benefits, a certain period of continuation of health coverage, a period of paid notice, or the right to exercise stock options.

b. Termination by the Employer Without Cause or Unjustified Termination:

Termination without cause by the employer or an unjustified termination should be defined in the contract and the specific exclusive triggering events should be listed to include death or permanent disability as to performance of the executive's specific job (not "total disability,") or any reason on a certain number of days notice. Unjustified termination could be defined to include circumstances including a material diminution of the executive's responsibilities, duties or reporting relationships without consent; a material reduction in compensation (the term "material" being specifically defined as a certain percentage of salary); failure by the employer to continue a benefit or compensation plan without providing the option of a substantially similar plan and benefits; non-renewal, or any termination of the employment agreement not preceded by the required notice of termination.

Unjustified termination can also include a change of control clause. Such a clause might accelerate vesting if a resignation or severance is related to an acquisition. These provisions might be modified if the separation is at the election of the executive.

Such an unjustified termination, or a termination without cause, should trigger specific entitlements which may include a certain term of full compensation; continuation of health and other executive benefits for a specified period of time or payment of an amount equivalent to the premiums required to obtain and maintain commensurate coverage; the right to exercise stock options supported by a vesting acceleration clause; a consulting agreement for an additional term and paid outplacement services for a defined period.

c. Termination of Agreement by Employee for Cause:

Provisions for termination by an employee for cause should be included in the agreement, such that an employee would be entitled on resignation to severance on a level as described in the event of termination without cause by employer, but including release from any post-employment covenants. Cause justifying resignation by an employee might be defined as intentional conduct by employer in violation of any law, rule or regulation affecting the terms and conditions of the executive's employment or requiring the participation or ratification of employee. In light of the Sarbanes-Oxley Act,² cause justifying resignation by the executive might be the employer's failure to provide directors' and officers' liability insurance or misrepresentations by the employer to the executive such as resulted in liability to the executive under the Act. It would be appropriate to include a reciprocal notice provision and opportunity to cure.

d. Termination by Employee Without Cause:

Unjustified termination of the agreement or termination without cause by the employee should provide for a notice period and would provide for a reduced level of entitlements to the employee.

5. Post-employment Provisions

a. Restrictive Covenants:

Restrictive covenants in Florida, entered into after 1996, are regulated by Section 542.335 of the Florida Statutes and modifying case law, and are generally invalid and unenforceable if they attempt to extend their obligations for too long a period of time or in a manner which is overbroad or unreasonable. The statute applies to all restrictive covenants that bar competition; prevent the use of trade secrets; prohibit solicitation of customers; piracy of employees; which require confidentiality or protect good will. Generally stated, the enforceability of such covenants depends upon the employer's demonstration that the contractual restraint is reasonably necessary to protect a legitimate business interest, including but not limited to matters such as trade secrets, confidential business or professional information; substantial relationships with customers and/or patients; customer or client good will in a specific geographical or marketing area, and extraordinary and specialized training. In order to obtain an injunction to enforce the restrictions, the employer must demonstrate an actual threat based upon a breach of the

² See, *infra*, at §7a.

agreement. If the employer so demonstrates, the employee must show that the proposed restriction is overbroad, overlong, or not necessary to protect the interest. On such a showing the court will modify but not eliminate the restraint. A restraint of between 6 months and 2 years is rebuttably presumed to be reasonable as to former employee, agent or independent contractor (trade secrets 5 -10 yrs. or less). Nationwide scope for a restraint is not prohibited if shown to be “reasonably necessary.” A former employee cannot raise an individualized economic hardship defense and the court will not construe ambiguities in the agreement against the drafter.

b. Post employment consulting services:

An executive might wish to negotiate for a guarantee of a contract for post-employment consulting services in the event of an unjustified termination by the employer or a termination for cause by the employee.

6. Arbitration Clauses

Agreements to arbitrate disputes related to employment and the agreement are nearly universally approved by courts and may even constitute a condition of employment. Generally speaking, arbitration agreements may apply to contractual claims (except those involving transportation workers) as well as claims arising under Title VII, ADA and/or the ADEA, and have been held not to limit a party’s substantive rights under those statutes. In fact, arbitration may be less costly for both parties and faster in resolving a matter than litigation. In addition, many attorneys find arbitral remedies more favorable for plaintiffs in certain respects than judicial ones.

7. Other Considerations

a. Sarbanes-Oxley Act:

The Sarbanes-Oxley Act may provide for the imposition of serious financial and criminal penalties upon CEOs and CFOs who knowingly sign financial statements that fail to meet its requirements, such as fines up to \$1 million dollars and incarceration for 10 years. “Willful” conduct may expose executives to up to \$5 million in fines and incarceration for 20 years. A financial restatement as a result of the “material noncompliance of the issuer, as a result of misconduct,” may result in the executive’s forfeiting of any share of gains or bonuses reaped within a year of filing erroneous financials. The Act has made it increasingly difficult to obtain liability insurance for directors and officers, because the policies contain exclusions for criminal acts. Some policies even exclude financial restatements from coverage. Therefore, prospective CEOs and CFOs should obtain a guarantee that their employer will provide director and officer liability insurance for financial statements and restatements. In addition, they may wish to explore independent contractor options during an initial period of affiliation with a prospective employer, which would provide them an opportunity to examine the employer’s records prior to assuming a position as CEO or CFO.

b. Integration Clause:

Most agreements will contain a clause purporting that the agreement and the documents incorporated by reference constitute the entire agreement among the parties, and supersedes any prior agreements, written or oral, relating to the subject of the contract. In general, this principle applies to contracts even in the absence of such a clause. Therefore, do not rely on verbal statements or documents exchanged prior to the agreement unless they are specifically incorporated by reference in the agreement.

c. Governing Law and Choice of Forum Clauses:

An employer with corporate headquarters in another state may well attempt to insert a provision in an agreement that subsequent disputes will be governed by the law of the state in which the headquarters of the operation are located, even if that is not where the agreement is to be performed or where the employee resides. In addition, the agreement may provide that litigation must occur at that location. An employee who agrees to litigate in the event of breach in another state or have the agreement governed by the law of another state should be aware that he or she may face severe inconvenience and increased costs in the event of litigation as well as be bound by laws which are different from those governing employment in the state in which the executive resides.

d. Attorneys Fees:

It is a general rule in contract law that litigants must pay their own attorneys fees to enforce a contract, even if they prevail, unless the contract contains a clause providing otherwise. Therefore, the agreement should contain a mutual provision stating that that, in any action arising out of the agreement or transactions contemplated therein, the substantially prevailing party shall be entitled to recover from the other party all costs and expenses (including reasonable attorneys fees) incurred, in addition to any other award made by the court in which the action was brought.

Conclusion

The foregoing presents general guidelines and not legal advice. The impact of various provisions depends upon each individual's situation and the current status of governing law. Always have an attorney review any agreement before signing it and again in the event of termination.

An Account Executive, an Account Director and their Managing Director are walking to lunch. When they find an antique oil lamp.

They rub it and a Genie comes out in a puff of smoke. The Genie says, "I usually only grant three wishes, so I'll give each of you just one."

"Me first! Me first!" says the Account Executive. "I want to be in the Bahamas, driving a speedboat, without a care in the world." Poof! She's gone.

In astonishment, "Me next! Me next!" says the Account Director. "I want to be in Hawaii, relaxing on the beach with my personal masseuse, an endless supply of pina coladas and the love of my life." Poof! He's gone.

"You're next," the Genie says to the Managing Director. The Manager says, "I want those two back in the office after lunch."

Moral of story: Always Let your Boss have the first say.