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Before You Sign

Executive employment agreements: A primer

Most relationships between employee and employer begin well. Not all end that way, and for those that don't, the terms of the employment agreement take on additional importance.

Courts deciphering the parameters of an executive's employment will first look to the existence of, and then the terms found in, a written employment agreement. A judge will look to the intent of the parties as reflected in the language of the document. Most times the court will not look beyond the document itself, and this is significant for an executive who believes some terms of his/her employment are also defined by conversations not reflected in the written agreement.

Broadly speaking, employment agreements may be broken down into five major sections.

1 Responsibilities of the Executive

One of the most important parts of an employment agreement defines the employee's title and duties. It is against this section that the employee's conduct will be measured. Satisfaction of the enumerated duties, responsibilities, and performance milestones typically correlates directly to compensation and year-end bonuses. Non-attainment of enumerated duties and responsibilities often leads to adverse employment actions.

When reviewing the employment agreement, make sure that the job description is accurate and reflects what you anticipate your responsibilities will be, or if the agreement is a renewal of a prior agreement, what your responsibilities actually are. Many agreements provide only generalized descriptions of a CFO's duties and responsibilities and

bear little resemblance to actual duties and responsibilities. You should ensure that the agreement is accurate.

Further, to the extent you have already or anticipate having an arrangement with your employer limiting your responsibilities in certain ways, these should be specified in the agreement. For instance, suppose your responsibilities do not include a certain affiliated company, or require you to be present in the New York office on Fridays, or anything else of a limiting nature. These limitations should be specified in the agreement to protect you down the road.

2 Compensation and Benefits

Nearly all executive employment agreements contain sections about base pay, performance bonuses, executive benefits, severance benefits, and related compensation matters. It is incumbent upon you to ensure that the compensation terms reflect the agreement you reached with your employer. To the extent you are able to negotiate these terms, take care to make the compensation terms as clear and definite as possible, and limit or eliminate vague language that seems to vest unfettered discretion in the employer. For instance, are bonuses to be provided based on the CFO attaining his personal performance objectives, the company attaining its performance objectives, or some combination thereof? Does the employer have the discretion to change the bonus objectives mid-year?

Tax consequences are another significant issue in any executive compensation scheme. Certain types of compensation receive better tax treatment. For instance, consider the differences between incentive

stock options ("ISOs") and non-qualified stock options ("NQs"). ISOs are a qualified source of deferred compensation that are more favorable because they are not subject to ordinary tax if exercised and then held by the executive for at least one year. If they are later sold, the gain is subject to more favorable capital gains rates. However, ISOs are subject to the alternative minimum tax when exercised and NQs are taxed as ordinary income when they are exercised. If an executive has a choice between the two, it helps to understand the difference when making a selection.

Executives planning on working across state lines will encounter a number of additional tax consequences that could be mitigated pre-employment by addressing how wages will be reported prospectively. For example, if an executive lives in New Jersey and is commuting to New York, any wages earned in NY are taxable in NY and the executive may claim a credit on his/her New Jersey return for some or all of the taxes paid to NY. If the executive is going to work from a home office for two days out of a five-day workweek, however, it is usually more beneficial to have two-fifths of the wages taxed in NJ and three-fifths of the wages taxed in NY. Getting the employer to commit to this up front can save the executive a lot of headaches. After the employment relationship is started, the executive is usually stuck trying to sort this out with the payroll department, which may be an outsource agency.

A related issue arises when the employer is located in a jurisdiction such as New York City. There are times when the employer wants the CFO to live in NYC during the workweek, and the employer will subsidize



an apartment. In this situation, if a non-resident taxpayer owns or rents a permanent place of abode (such as a rental apartment), and is in NY or NYC for more than 183 days out of the year (even if only in NY/NYC daily for a very brief period of time), NY or NYC will treat that executive as a statutory resident. If that occurs, NY/NYC will pull all of the executive's income into NY/NYC, which can create a large and unexpected tax burden. In this scenario, the CFO may be better off having the employer rent the apartment and let the executive use the apartment at his/her convenience (i.e., no sublease). This course of action helps to remove the executive's nexus from NY/NYC.

An additional issue concerns a change-of-control provision. Broadly speaking, this type of provision protects the executive in the event the company's management undergoes a change in control. In those instances, a CFO could find himself/herself seeking new employment. A change-of-control provision cushions the executive by providing for a specific (typically significant) amount of compensation. Care should be taken when reviewing the definition of what constitutes "change-of-control" as well as the nature of the compensation. For instance, a provision awarding compensation based on a formula or other calculation leaves the amount less definite as compared to a specific sum.

3 Termination

In some ways, the termination section of the employment agreement is both the most important and the most overlooked. No one beginning employment wants to consider what happens at the end of the employment, especially if the end does not come well. However, this is precisely why termination provisions are so important. Courts parsing the breakup of the employer/employee relationship will first turn to this section, as it defines what the employer and employee expected and agreed to at the start of the

employment relationship.

Does the agreement permit termination without cause, meaning the executive could be terminated for any reason — or no reason? The alternative is that the executive may be terminated only with cause, or, even better, for certain specified enumerated causes.

Without-cause termination could allow an employer to essentially treat the executive as if the agreement, and its expected term of employment, is modifiable at the discretion of the employer. Is notice required and an opportunity to cure afforded? Does the executive still receive compensation through the balance of the term of the agreement? Is severance to be paid? If terminated mid-year, is the executive still entitled to bonus and other executive benefits and awards? Is a limitation on post-termination employment (see below) still

valid if termination is without cause?

Other termination issues center on the employer's willingness to assist (or ability to hinder) the employee in the finding of subsequent employment.

4 Treatment of Confidential Information

Most executive employment agreements contain provisions restricting the executive's use of the employer's "confidential information." Some merely define what information is confidential, put limits on how the executive may use it, and preclude the executive from divulging it to outsiders. Given the breadth of information maintained by employers, the executive should look to obtain highly specific and detailed descriptions of what the employer claims to be "confidential."

Some agreements also contain what are called restrictive covenants. These clauses prohibit the executive from competing against the employer both during and after employment, and may take a number of forms. Some prohibit soliciting the employer's customers, vendors, and employees. Some prohibit working for a

competitor outright. New Jersey courts generally disfavor restrictive covenants but will enforce them if they are reasonable in terms of geographic scope and duration. Consider whether the scope or applicability of the restriction might be lessened, or whether severance should be paid while the executive is restricted, particularly if the executive is terminated without cause.

5 Miscellaneous Terms and Conditions

Employment agreements contain dozens of other provisions, many of which are very important. For instance, does the agreement contain a clause requiring that disputes be arbitrated instead of being heard in the courts? Does it contain a clause allowing the employer to demote the CFO to another position but still keep him/her employed? Does it specify the number of support staff the executive will have, to ensure he/she is not overwhelmed by unrealistic employer demands and expectations?

Also, there are often provisions tucked in unexpected places of the agreement that relate to other sections of the document, modifying or limiting the other sections. The bottom line is that the entire agreement needs to be reviewed and analyzed, both as to specific provisions and as to how the provisions interrelate.

Conclusion

As should be clear from the above, executive employment agreements involve critical choices. CFOs should seek legal and tax advice before agreeing to sign one. And, although no one expects the worst from a new employer, one should plan for it by negotiating the best terms possible in any employment agreement, as that document will be central to defining what happens in the event of an employment separation. ✦

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