

**WORKING DRAFT**

# **How to Get It In Writing**

An Executive's Guide to Employment Contracts and Negotiations

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[taken from website on findlaw] **Most D&O policies exclude claims for acts of dishonesty and fraudulent or criminal conduct. These exclusions also raise a number of questions for officers and board members, including:**

- Are the D&O exclusions triggered by mere allegations of dishonest, fraudulent or criminal conduct? If so, the insurer will refuse to pay defense costs, even to a frivolous claim.
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## **INTRODUCTION**

### **Promises Promises**

This book is for everyone who works. If you have a job, you have an employment contract. It may be oral, and it may offer you no protections. But you've got one.

Since you're going to have an employment contract, I'd like to help you get the best one you can — in writing. Because getting the contract right and getting the job itself often are intertwined, they are treated that way in this book.

This book will most benefit senior executives and future senior executives. But everyone needs, at a minimum, a clear commitment from his or her employer as to exactly what the deal is. How many times has a job turned out to be something other than what you were told? How many times has your success been undermined by a lack of opportunity, training, time, resources, or authority when those things were promised to you orally, just not provided? How much happier and/or more successful would you be now if you'd had those commitments written down clearly in writing before you accepted the job?

Those all are problems that a good employment agreement can solve — problems that you can solve for yourself using the information in this book. This book goes farther, though, to address at some length the issues raised in full-blown 30 page single spaced employment contracts — the kind that privileged senior executives enjoy, the kind we deal with regularly at my law firm. At a minimum, this book can serve senior executives by providing a checklist of things to ask for and watch out for. But beyond that, I know it can help them—and all employees—get what they deserve, namely, whatever their employers promised.

In sharing this information, I will wax poetic about sales, communication, and negotiation — processes that are joys and keys in my work, and should be in yours (whether or not you've already embraced that fact). I'll share a few anecdotes and horror stories for entertainment value and to illustrate why the information in this book is so important and how to use it. And I'll give you a checklist that will help you think about what you want in an employment arrangement. After all, negotiating skills are useless if you don't know what to negotiate *for*.

If you have a good lawyer, you should still use him or her. And if you don't have a good one, you still should hire the best one you can afford. After all, one fundamental reality of the employment situation is that you should let someone else negotiate for you if you can—it keeps you and your personal relationship with your boss outside the fray. But you'll learn enough here about the basic practical and legal issues of employment contracts to protect yourself better and get what you should get, whether you're negotiating for yourself or just directing your lawyer.

### **A Clear Written Contract Is Good For Business**

Here is the heart of the matter: Clear written contracts are the ultimate in good communication. And good communication is essential to business success.

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If you have been reluctant to address the need for a written employment agreement, that may be because you're a decent, honest, hardworking person who deals in good faith and only wants to deal with similar people. Perhaps you're happy having a handshake deal with someone you trust. Or perhaps you have no confidence in your ability to handle the process, and so you avoid it.

Good leaders are trustworthy, and often are trusting in nature. They deal in good faith. They give people the benefit of the doubt until experience teaches them that a particular person is not to be trusted, or until experience makes them cynical. And then, as they should, they lament their cynicism.

But you don't have to be cynical about your agreements with the people you work for, or about contracts in general. I'm going to give you the tools to avoid or minimize the problems that most often arise, and ensure a solid foundation for your business relationship. Some of what I'll show you here applies not just with your employers, but with your subordinates, your customers, and even your family and friends. All of those arenas require good communication and commitments. I'll give you essential, specific, and moderately detailed information about employment contracts.

In global terms, here is what I'm here to tell you, and it won't surprise you at all: *Simple, clear, universally understood communication is the key to success in any group.* Napoleon reputedly ensured the clarity of his field orders by limiting them to one page, having his corporal read them, and making certain this corporal completely understood the plan based solely on the written order. If not, it was rewritten. This kind of effective communication is your responsibility every day as a friend, family member, employee, manager, or leader of any kind. *If you want your employer to see that you can do it, show them up-front in the way you handle your employment negotiations.*

Many feel that asking someone to "put it in writing" is equivalent to saying "I don't trust you." Said that way, perhaps it is. And trust inarguably is an essential element of good relationships. But working together on a clear written statement of what two sides intend to do for each other is a totally different thing. It's like a mission statement. It's a way to ensure both sides have a shared objective. It's a team building exercise that can determine whether you should be working together and whether your relationship will succeed. A shared goal is necessary for team success. A shared plan allows a team to work together. So you'd better all agree on the goal, and on how to achieve it. Detailed work statements and agreements contain the sub-goals and specify the methods that will enable you and your employer to succeed.

In helping my clients, I have seen what too often happens when a naïve desire to trust results in a failure to write the deal down clearly and specifically. This is not because you cannot trust people (though sometimes you cannot). It is because *the two most honest men in the world can wind up calling each other thieves — and losing a lot of money — if they have honestly differing understandings of their agreement.*

**A job is too important a part of your life for you to approach it cavalierly. Jobs too often aren't as billed. Too often your actual authority is insufficient, promised resources aren't provided, promised personal development opportunities are not provided, your area of responsibility receives lower priority than promised, others in the company fail to pull their own weight or betray your trust to protect their**

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**own interests, or political currents you could not possibly have known about compromise your success and future happiness.** Often these things occur for perfectly legitimate reasons that nobody told you about. That is the problem with taking a job based solely on what is said to you during a “courtship” interview process and before you get on the job and learn the business and political realities of the place. For these reasons, as you’ve probably heard before, “an oral agreement isn’t worth the paper it’s written on.”

A written agreement isn’t worth much either unless it reflects a clear and truly shared understanding of the deal. Lawyers call this a “meeting of the minds.” In negotiating your employment agreement, or any other deal, you have one, transcendent, overarching objective: **Make sure all parties see the same picture and agree that’s what they want. The only sure way is to write it down in comfortably spaced, simply worded, understandable text that is not reasonably subject to more than one interpretation.** And this is no easy task. Anyone who writes knows it is a skill, and it takes work. But that work is worthwhile. Just as you should not act without a plan, you should not work without a contract — not if you can help it.

This is important: Getting a written contract does not mean you need something on legal size paper with lots of WHEREAS’S, flourished signatures, gold foil, and a notary’s stamp. It does not mean you need to get your employer to write you a contract. A simple letter by you to your employer confirming your understanding of the job and terms can suffice (there is an example in this book at page \_\_\_\_). In the end, it’s just about good communication, about making sure everyone is on the same page.

### **Contracts Are Sales Opportunities, Not Sales Problems.**

Finally, it’s essential to understand that getting it in writing is not an impediment to making a sale. Whether you’re selling your own services, your company’s services, or a widget, the contract is one of the best sales tools you have. The written contract determines whether the deal is closed. When you present it, your prospect will either sign it or decline. If they decline, you can ask why. And then you can overcome the objection. Only when the contract is signed and clearly addresses all the issues do you truly have a “closed” sale. A lot of sales people don’t really close, and the result is a lot of sales are temporary—delivery never actually happens, or there is no second order. You certainly do not want to have that problem when it’s your services you’re selling.

If the other side objects to a proposed term of a contract, the solution is simple: communicate. If it’s something you reasonably need, explain why. If you’re being reasonable and can articulate why, you should get what you’ve asked for. Similarly, if you’re objecting to something they want, they should be able to articulate why they need that, consistent with your own reasonable expectations. If they can, then you should give it, so long as it the deal still makes sense for you. Negotiation in this context is all about making sure each side’s reasonable needs are met. If so, you have a deal. If both cannot be met, no deal is possible. And if someone unreasonably refuses to give what is reasonable, that is not a person, or company, to do business with. In short, a contract allows a salesperson (including you when you’re selling yourself) to identify and, if

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possible, overcome a prospect's objections. That, as all good salespeople know, is the key to closing a sale.



## RAY GALLO'S SHORT COURSE IN NEGOTIATION

What follows is a one simple model of how to negotiate, particularly in relationship forming deals. It is a synthesis of what I've learned in 20 years as a salesman, negotiator, and advocate, applied to the employment context. What I want to suggest to you is that by getting into the right state of mind and holding to a few highly ethical principles, you will better serve yourself and your employer both.

If you want to get what you're worth, make your life easier, and do right by your employer, I don't think you have any choice but to negotiate. If this makes you uncomfortable, I have good news for you: Negotiating does not mean haggling — the terms are not synonymous. Haggling is a street version of what can and should be a very classy and enjoyable process, especially when it involves your job. You can and should negotiate simply and fairly by engaging in an honest and rational discussion of what both sides reasonably need under the circumstances. It's about what's fair. So buck up. There's really nothing to it except being honest and direct, which we all must stand up and do sooner or later if we are to enjoy happiness in life.

### Lesson 1: Empathy and Purpose

Empathy and Purpose: These two words contain all the wisdom of every good human relations and self-help book written. Use them as memory keys to remind yourself of the myriad things they represent. They hold most of the keys to effective negotiation.

#### Empathy

The first step to successful negotiation is understanding the other person's perspective, in other words, empathizing.

Empathy means putting yourself in the other person's shoes. And not just superficially. I mean actually sit back, close your eyes, and picture yourself sitting behind your would-be employer's desk. Imagine his personal and professional challenges. What is he feeling? Why is he talking to you? What does the company need? Where is it struggling? How can he fix it? What's the culture like? What's going on with him personally? Is he happy? Why or why not? What sort of person is he and what sort of people does he want around him? In short, what does he need?

Paying attention to what he needs will tell you what it is you need to give in order to get what you want in return. Re-read that last sentence a couple of times. It's essential that you understand that *negotiation* (at least in the employment context) *is in a significant part about getting more by giving the right things*. Often, that just requires describing yourself, and planning what you'll do at the company, in terms of what you know the company needs. Sometimes, you'll need to point out for the company what it is they need and that you can deliver it.

You can do this if you do your homework. Often, your would-be employer will demand one thing thinking that's what he needs. You'll want to show him, in a politic way, that you can give him something else that actually will better address his needs. This is how you avoid giving something you don't want to give. You can't refuse to give

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what's important to him and get the job. But you can influence what he finally decides is important.

On an interpersonal level (and the personal level always counts) there are some universal answers to these “empathy questions” that you should always keep in mind. What he wants (what we all want) is to feel important, appreciated, successful, secure, and liked. What he wants is for someone to solve his problem — whatever it may be.

We often get so wrapped up in the self-examination and self-promotion that surrounds a job search that we forget that the best interviews are given by those who remember to connect personally with their interviewer. We all hire people we like. So take the time to connect on a personal level. It's a lot easier for you as a prospective employee to negotiate with an employer who likes you. And it's almost impossible for him not to like someone who genuinely, warm-heartedly, likes him. (Hence, “man's best friend” is the most likeable, honest, expressive, happiest to see you, creature on earth.)

It really is that simple. Negotiating well in this context is about being a good human being. Let me give you a little more detail: Smile. Be friendly. Make yourself human. Be interested in the other person. Talk comfortably (but briefly and generally) about your own family, little daily problems, *etc.*, as a way of letting him into your life. Be modest in a charming way. That will make him comfortable with you. Then make him feel good about himself. Show an interest in him personally by asking and talking about things that are important to him (figure out whether it's his family or job or hobbies that really make him tick and focus conversation on this for a bit—what's on his desk and his office walls can give you big hints). Talk about the company and his job in terms of his interests and responsibilities. Monitor his comfort with any given topic. Let the conversation go where he's happiest. Praise him honestly if you can. But don't overdo it, and don't strain to do it. And you don't have to lie. You always can say you respect what he's accomplished and leave it at that. Remember the last time somebody genuinely complimented you? Most people can live for days on a good compliment. And I don't mean flattery, which is false praise. Flattery is annoying. I mean find whatever it is you genuinely like or respect and let him know. He'll remember you for it, even though he knows what you're up to, and will appreciate it if he sees that you are being honest.

In short, be charming by being a good human being. Like your future boss and he'll like you. Then you'll be on your way to getting a job offer and being able to negotiate its terms.

### **The Magic Of Emotions**

Negotiation is an inherently emotional process, like all human interaction. Some people are particularly adroit at controlling the emotional content of an interpersonal situation, *i.e.*, controlling how they're making the other person feel. They are the great salesmen, orators, seductors. If you're one of these people, then you know it. But regardless of your current skill level in this arena, you will benefit from additional focus on it. To sell or negotiate successfully you must (1) master your own emotions and (2) become sensitive enough to see how you're making the other person feel, so you can change what you're doing and feeling to get the desired result.

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By mastering your own emotions I do not mean you should become stoic. I mean choose to experience positive emotions. Because that is how you influence others to feel positive about you and what you want. Allow yourself to feel warm, kind, honest, and productive. ***Authentically become those things.*** Give yourself permission to feel affection and respect — not just intellectually, but throughout your nervous system. Allow yourself to feel it deeply enough that your body gives you the hormones that come with those emotions. Feel it authentically.

If you can do this then I guarantee the people around you will respond authentically in kind. If you cannot be genuinely caring with people, you will have a truly uphill road and may need to look for a job that is purely intellectual where you can succeed without interacting with others. If you can find within yourself the honest, positive emotions that draw others to you and cause them to feel similarly positive, then you hold the keys to great influence — including influence over your employer and the ultimate terms of your deal.

This does not mean you should become a babbling or hyperemotional idiot. Professionals are contained. If they have outbursts, those outbursts are planned carefully.<sup>1</sup> But while remaining contained, you can be happy, positive, energetic, and interested.

This is a gem worth many times the price of this book: ***Just like dogs smell fear, people around you, including those to whom you are selling your services, sense any negativity, hesitancy, fear, or doubt that you feel — even the fleeting doubts. If you feel like you do not deserve what you're asking for, if you are uncomfortable in any way asking for it, your prospective employer can be counted upon to sense this and to mirror your negative feeling by saying no — maybe without even knowing why. By contrast, if you absolutely believe, and the positive emotion of assurance shines in your eyes and your skin, and shows in your body language, then your belief will be marvelously infectious. And everyone will be happier. Your employer will know you're the right person because he can see that you know.***

In short, you gotta believe.<sup>2</sup>

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<sup>1</sup> Herb Cohen, in his book “You Can Negotiate Anything” tells a great story about an executive who, in negotiating the one, final \$100,000 point in a multimillion dollar deal lost his temper and slammed something down on his \$5,000 glass conference room table — shattering it (presumably it was safety glass). The \$100,000 point was conceded by the shocked participants. Asked why he did it, the executive explained: I go through five of these tables a year at an annual cost of about \$25,000 and an annual profit of \$475,000. I’ve paraphrased this example, but you get the idea. A more detailed discussion of tactics like this I’ll leave for a more comprehensive book on negotiation. (By the way: I only can assume this was a safety-glass table. Otherwise, his liability for the injuries might well have exceeded the benefit of the \$100,000 point. Also, one would think that after the first couple of tables people would be expecting this bit of old-hat and would politely insist on relocating the negotiation to a place with stone tables.)

<sup>2</sup> There are a lot of ways to become a true believer in yourself even if you are full of doubts just now. Churches preach prayer. Stuart Smalley (Saturday Night Live) recommended “Daily Affirmations.” Some guys have a shaving routine. Others re-trench, start simply, and build a track record they and others can see shows a pattern of winning. I think success is what’s required, and that everyone needs to start with small victories are their own level and build (usually through dedication and determination) on that. Use whatever works for you.

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### Purpose

By “purpose” I mean that you decide what you want and keep it always in mind when negotiating. If that sounds simple or obvious to you, you’re probably the driven, high achiever who I expected would buy this book. But when we talk about negotiating your employment contract, we’re talking about getting down to a level of detail you may have avoided in the past. We’re talking about what you may feel are “minutia” that only lawyers would worry about. I assure you that these details can make a big difference in the quality of your employment experience. Seemingly small details can make hundreds of thousands of dollars of difference — even millions of dollars of difference if your contract is big enough.

So the first step in getting what you want from your employment agreement is to carefully consider everything that you could possibly ask for from this job. I mean it. The sky’s the limit. If you could define your job title, description, responsibilities, staffing, financial resources, pay, benefits, duration, what bad things could happen and who bears the risks of those bad things happening, what would you want?

In the second part of this book, “A Crash Course In Employment Contracts,” I go into some detail about the various problems that can be addressed in employment contracts and the provisions that can be used to address them. That part of the book will help you to develop a checklist of what you want and don’t want in your contract.

Here, you need to do something that may sound a little absurd: Try and empathize with yourself. Get in touch with your own needs. What is it that you need personally and professionally? Where are you at risk? What would unemployment do to you? How much cash do you have in the bank? How much income security does your spouse have? How many times have you changed jobs already? How much flexibility do you need for yourself, your kids, charitable activities, managing your investments, other projects?

I do not mean to tell you how to decide what job you want. But you’re reading this book to learn how to get the job you’ve already decided you want *on the best terms*. And that means you need to clearly formulate exactly *what terms those are*. And then keep them prominently in your mind throughout your interactions with your prospective employer. Losing track of your objectives is a sure way of missing an opportunity to address something important.

Go after what you want. How many times have we all rolled our eyes at a sweet, bumbling hero on the big screen, wishing he would just kiss the girl? Negotiation is a lot like that. ***Ask for what you want the first time the other side is ready to be asked for it.*** Because that means they’ve decided, like the girl in my example, that you both want the same thing. And if you miss that opportunity, you may not get another one. And you’re very unlikely to get any other one that’s as good. Just like our hapless hero and his (now uncertain) love interest. Know what you want so that you can ask for it as soon as they want to give it to you.

Incidentally, ***there will be times when by engaging in an active negotiation process you will find that a job you thought you wanted is in fact the wrong job for you.*** This is good. It is far better to discover the job is wrong before you accept it than two months

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later, when you've let other opportunities go and have to face the resume problems of quick job hopping or searching for a job without already having one.

Now, if you've followed these steps, you know what you want and have resolved to keep both of these things firmly in mind. You're ready to engage in dialogue.

### Lesson 2: The Art of War

The art of war, if you believe Sun Tzu, is deception. Deception can play a legitimate role in negotiation. For example, you may need the job so badly that you would take it on any terms. It is best to keep this to yourself. If they knew that then they probably would not hire you (there must be something wrong for you to be so desperate, and your desperation increases the risks associated with hiring you, since you'd probably take the job even if you're not right for it or it's not right for you). They certainly won't pay you top dollar, since they don't need to.

So long as you're not misleading your prospective employer about your qualifications, ability to do the job, and intention to do the job, I think it's fair to hide how badly you need the job. If they really want to know how desperately unemployed you are, they can probably find out. And if they don't care enough to check . . . .

But deception generally is the last thing you want when negotiating your deal. A liar is not someone anyone should hire or work for. Moreover, deception is antithetical to reaching the kind of fair, clear, unity of purpose and understanding that you want to reach. In the context of negotiating an employment agreement, and most other agreements, it's wisest for everyone to be candid about what they want and what they have to offer in return — that way a fair and profitable trade can be made.<sup>3</sup>

#### Problem Solving

Still, the art of negotiation, like much of the art of war, lies in tactics. The tactics I recommend are those that will identify the deal that gives both sides what they need. The art of negotiation lies in perceiving what your prospective employer really needs, does not need, what his alternatives are, and what, therefore, it is reasonable for him to give you. Let me give you a simple example.

Suppose that you are an experienced Chief Operating Officer and you're trying to break through to a CEO position. In order to get your first CEO job, you've decided you're willing to work for a smaller company than you have recently, and for this small Company, and based on its current performance, your salary request is too burdensome. Do you give up the money or pass on the job? Either choice might be sensible. But the great negotiator is, if nothing else, a problem solver. This company needs you. You want the job, but you need more money than it can afford to pay you. There may be a solution. What about making up the difference in stock options? What about making up the difference in bonus pay that is contingent on sufficient profits to make it rational to pay you? Any of these might give both sides what they need. You can agree to bear the risk,

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<sup>3</sup> It might be different if you were planning to do one last deal and then leave the galaxy, such that your integrity and reputation in this one became irrelevant. That never will be the case. Safeguard your integrity. You'll do better and sleep better both.

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and receive the reward, of the company performing at a level needed to support your pay. And since you're taking a risk of not earning that market rate of pay, you should have the opportunity to earn a premium to market. Here's why.

### **Risks and Rewards**

Risk allocation is a primary purpose of every contract. The more senior you get, the more detailed your contract can be expected to be and the more risk allocation will be addressed in it. One key concept that applies time after time is the concept of risk and reward. They should go together. Whoever takes the risk gets the reward. It's like gambling. If you ever studied basic economics, you'll remember the basic idea. Using the above example, your pay was conditioned on the profitability of the Company. You agreed to bet your bonus pay that you could manage the company to sufficient profitability that it could pay that bonus. Accepting that risk, you enjoy the benefits if all goes well.

But you should get more here than just a bonus to make up for the additional salary you wanted. Your bonus just gets you to your market salary pay rate. For assuming the risk of not getting that pay rate, you should get more than just market salary equivalent. So you also should ask for stock options or more bonus pay for a total compensation package that exceeds your cash value by a sum sufficient to compensate you for the risk you accepted of getting less than market pay. After all, you're giving them someone more qualified than they can afford and only asking that they share the upside with you. They won't be giving anything of value away unless you perform, in which case (assuming somebody does the numbers correctly) they'll still be ahead on the deal. Either way, you get your CEO slot and a fair compensation package.

This principle applies whenever an employer wants you to work for less. Any time the employer wants to shift risk to you, that's perfectly acceptable provided that (1) you can afford the downside risk (*i.e.*, in the preceding example, you won't miss your house payment if you don't get the bonus) and further provided that (2) you are being adequately compensated for taking that risk.

Obviously, it is essential to recognize what risks you are taking. One primary function of your lawyer is to help you identify the risks inherent in any proposed contract. The best lawyers are great at this. Make sure you find someone like that.

Below, in discussing the various contract provisions you may run into, I address a number of risks you may be asked to bear. In each case where you agree to assume one, be sure you are appropriately compensated.

### **Lesson 3: You Just Want To Be Fair**

When you're trying to motivate someone, a simple way is to appeal to his or her sense of decency. A good friend and client of mine, a graduate of West Point and the Harvard Business School, loves to disarm his opponents in negotiations by saying: "I just want to be fair."<sup>4</sup> How can anyone argue with that? How can anyone condemn, distrust, or dislike that motivation? This is a magnificent tactic for creating the environment of

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<sup>4</sup> He attributes this gem to me. But I'm pretty sure he deserves the credit—at least for this particular language if not for the concept.

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open dialogue that you want. They'll have to say that they want to be fair too, and then the dialogue is truly a bipartisan analysis of what's fair — which with rational people is all that is required for you to get what you reasonably are entitled to get.<sup>5</sup>

Having once attained an open, “how can we help each other” dynamic in your discussion, you can proceed to help each other identify your respective needs and how to integrate them into a mutually beneficial solution.

### Lesson 4: Game Theory

In high school I always won at poker. But honestly, I grew up in a small town. Playing poker in college at Yale was a real ego injury. One of my best friends (one of those scary guys who received a perfect score on his math SAT) had studied game theory. And I hadn't.

He played poker with an abandon and glee that was totally disorienting. He'd bet without looking at his cards. He'd bet amounts that made no sense based on the cards showing at the time. And at the end of the night, he was nearly always the big winner. Because there was no easy way to tell when he was bluffing or what cards he might have. What was it he knew that I didn't? The answer is that he knew a something about game theory.

What is game theory? I am no mathematician, and I won't pretend to cover more than the one simple point that explains why my friend won at poker. In the context of poker, Game theory teaches, correctly in my experience, that by introducing uncertainty into the opponent's analysis you increase his perceived risk and increase the value he places on avoiding that risk. By doing that, you obtain a tactical advantage.

In hostile negotiations like lawsuits, and whenever I play poker, I apply this lesson that I paid my math genius friend to give me. When the opposing party to a lawsuit believes you're irrational enough to spend \$400,000 in legal fees fighting over a \$200,000 dispute, they just might agree to pay you the \$200,000 to save spending \$400,000 themselves in fighting over it. In poker terms, you've got to be able to bluff — and you can't bluff if they know you're 100% rational.

I wanted to explain this here because not even a short course on negotiation is complete, in my view, without it. But having explained this, please understand: In my view, game playing of this kind, though often profitable, has little if any place in an employment negotiation: You don't want your future employer to think you're irrational.

Here is the limited application of game theory in employment contract negotiations: What your prospective employer doesn't know you can use to your advantage. The simplest example is one I already shared: They just don't need to know that you desperately need the job. Similarly, they generally won't know what other companies you may be talking to. While some industries are so small they can't help but know, in many cases they'll have no idea. I think it's perfectly reasonable to bluff a little here and let them think you have other opportunities. This enhances the perception that your services are in demand and have substantial value.

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<sup>5</sup> And remember: you don't want to work for (or otherwise do business with) people who aren't rational.

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But don't lie. It's dishonest, and nobody wants a dishonest employee. And don't kid yourself. If you've really got the cards, they're more valuable than bluffs and nuances. Play them. Make your would-be employer face the competition and beat that competing offer — if hiring you on those terms is indeed the right thing for that employer.

This raises an important aside: Do not make a deal that is too burdensome for the employer. If they can't afford you, don't let them agree to pay you. The company will fail. You will be out of a job, and mostly recently will have been associated with a company that failed. Or you won't get paid. None of these are good outcomes.

One final point about competing offers: When you have them, get a written contract signed on the terms you want *before you reject your alternative offer*. This is the best and simplest kind of leverage. If you lose your alternative job before the contract is signed, if you accept a job by saying yes to an ill-defined verbal offer instead of by signing a clearly written contract, then you've lost your best chance of getting the details to work out in your favor. And the details often are crucial. A client of mine, a Fortune 500 Chief Marketing Officer, made this honest and good-faith error in a recent contract negotiation. He turned down his other opportunities and started work at his new job based on a verbal agreement that only covered the major points. With no remaining leverage, he was unable to negotiate the details, and his contract, signed perhaps six months later, was less favorable on all those smaller points than it would have been if it'd been fully negotiated and signed before he started the job and turned down his competing offers. Get the deal inked and signed before you turn down your alternatives. (And don't let someone rush you because they need you to start work the next day. It's OK if the lawyers are up late that night getting it done, and you'll almost always find they didn't write it like you understood it. Some more negotiation almost always is required. One other benefit of taking this position: a contract negotiation can last a long time, but it won't if the deal hinges on getting it signed promptly, or if someone needs your services tomorrow. If necessary, get the employer, its lawyer, yourself, and your lawyer in room with a computer and don't come out until the contract is signed and in your pocket. Again, staying up late one night beats negotiating for weeks. It'll be good to have it done.)

### **Lesson 5: No Deal Is Good Unless Everyone's On The Same Page**

No deal is good unless everyone has the same perception of the agreement. You can make a deal — orally or in writing. And then something happens, like you get fired, and all of a sudden it's clear there is no meeting of the minds as to what severance you're entitled to, or whether they can fire you at all under those circumstances. This can happen because the issue was never addressed, or because the language of the agreement is subject to more than one interpretation. It's virtually always the result of failing to discuss the eventuality and plan for it. Writing clear language that would govern the situation will avoid this.

I represented an executive who agreed to act as COO of a start-up company. Because it was not yet adequately funded (let's assume it needed \$10 million but only had \$3 million, he requested that his stock options be protected against dilution up to the reasonable total initial funding level, *i.e.*, the level at which he felt it should have been funded before he started. A written agreement was signed that gave him his fixed



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percentage (let's say 2%), with no dilution, through the first round of outside financing — which it was anticipated would raise the total paid in capital to the needed \$10 million. This seemed reasonable to everyone.

The initial round of funding was lower than expected — just \$3 million. It was completed in the fall of 2000, and the business made good progress. Shortly after the first round funding, a name CEO was hired and my client became CFO. The downturn in the financial markets from 1999 to 2000/2001 made it difficult to obtain additional needed funding, and in late Spring of 2001 the company cut costs by terminating a number of employees, including my client.

The company paid my client severance, but refused to honor the anti-dilution options as to any further financing, taking the position he was not entitled to any options to protect against dilution by money raised after his departure. This seemed fair to them. In my client's view, of course, the dilution protection was just there to assure him of what he reasonably could have insisted on *before he accepted the job* — that the company be adequately funded and that his options grant him an interest in that adequately funded company.

Obviously, my client tried to be reasonable by not insisting on full funding from the outset. Instead, he reasonably negotiated for provisions that protected his financial interest against at least some of the adverse effects of that inadequate funding. This was a good deal for everybody. My client got reasonable written assurances and the company got its COO — a guy with a proven track record. Still, a relationship damaging dispute resulted.

I won't go on about why I think the company took the unfortunate and unfair position that it did except to observe that once the employment relationship terminated, the employer's need to keep my client happy and feeling fairly treated disappeared. At that point, all that mattered was the extent of their legal obligations. A clearer contract would have prevented any argument.

In the end, what my client had was sufficient for us to get what he was reasonably entitled to receive — it said he was to be protected against dilution. But its ambiguities were enough that he incurred legal fees in arguing about it, and his relationship with the principal was damaged by the dispute.

The moral is simple: Make the deal so clear that there can be no misunderstandings. This is sometimes impossible. But it's your goal. The closer you come, the safer your future is.

### Lesson 6: How To Get It In Writing

I promised to tell you how to get a written contract. There are two primary techniques I advocate. The first is: Write a confirming letter. I mean if you've been offered a job orally go ahead and follow-up with a responsive letter of your own. Recite your discussions with your prospective employer, what the company's position is, what its plans are, what it needs from you, the terms on which they'd be willing to employ you, your career path at the company, the standards by which your performance will be judged, the rewards expected for meeting goals, your responsibility and authority in the

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job, the resources that will be put at your disposal, and everything else you can think of that's important to you, that they told you, and/or that your decision to accept their offer will be based upon.

If you do this right, they'll respect and appreciate you for it. And here's the really good news: If done right, it's legally enforceable as a statement of the deal. If you send a confirming letter like the one below, and no one bothers to write back and say: "No, that's not it," then you have deal on the terms confirmed.

Here is a modest example:

Dear Lisa:

I really enjoyed our meeting Wednesday and I am looking forward to confirming all the details and starting work at Yourco, Inc. I particularly am encouraged by the relationship I anticipate you and I will have. Your knowledge of the industry and my marketing skills should assure the Company's planned expansion succeeds.

I want to confirm and clarify our discussions to make sure we're on the same page as to my job and the terms we're both comfortable with. Following is my understanding of our plans and agreements based on our meeting. Please let me know promptly in writing if I've got any part of our deal wrong, as I intend to reject my other job offers on this basis.

First, you're looking for a President and CEO who will be active in business development for the company. In other words, this position has an emphasis on outside activities that promote sales. Since that will take up nearly 50% of my time, I'll have the authority to hire a COO with superior qualifications and at the high end of the pay scale for COO's in the industry. This will allow me to delegate all operational concerns beyond those at the very highest level, and to get meaningful assistance with respect to the development and implementation of strategy.

You've indicated that the board of directors is looking for someone who will work very independently, and that as far as reporting you want just a short monthly report of our progress and financials — we'll meet quarterly to discuss any concerns the board has. The board will leave strategy to me within the broad guidelines we discussed, which are that to improve profitability the company's manufacturing operations require a \$4 million technology update and, on the marketing side, need a comprehensive marketing effort to position us as the highest quality, higher price provider. This marketing effort will include significant PR efforts and print advertising in first tier national periodicals like Forbes and The Wall Street Journal.

I also understand that so long as the company meets its numbers goals, the board is prepared to give me free reign as to marketing strategy. I've attached a spreadsheet showing revenue and profitability goals consistent with what we discussed. I understand that if I meet these goals I will meet or exceed your expectations.

To enable me to meet these goals, and make the investments mentioned above, the board has agreed to authorize and spearhead a private placement to raise an additional \$10 million in equity financing within the next six months. We both agreed this would be required to finance the company's growth plans.

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You've agreed to my salary needs of \$250,000 per year plus options on common stock of the company. The number of shares optioned will be equal to 3% of the number of shares outstanding as of my start date. The exercise price will be the most recent private sale price at the date the options are issued. The options will vest evenly each month for 60 months on the first of each month after I begin work. You've also agreed to a performance bonus equal to 10% of the increase in profits. Profits will be measured by a fiscal year to fiscal year comparison and will be paid annually within 60 days of fiscal year end. We expect this will result in an estimated \$250,000 to \$1 million in annual bonus pay.

My personal expense budget for travel and entertainment in promoting the company will be \$150,000 per year.

To facilitate marketing efforts we specifically agreed, as a matter of strategy, that the company will fund a personal public relations campaign for me in a reasonable amount. We generally agreed that \$5,000 per month would be an appropriate budget.

Finally, since I'm leaving a long term job and taking the associated risks, you've agreed to severance pay of one year's salary if I am terminated without good cause at any time during the first three years, and six months severance pay if I am terminated without good cause after the first three years.

There are a couple of open items that we didn't discuss that are potentially important to the company and to me. First, the Company may want a confidentiality agreement and an assignment of all intellectual property I develop on company time. That is fine with me. The company also may want a "full employment" clause banning me from outside business activities so as to assure itself of my full attention. This will be fine with me within reasonable limits. Specifically, it's fine as long as I can continue to sit on a couple of outside boards of directors, continue with my existing charity work, and continue to manage my existing investments in a couple of small companies that occasionally require a few hours of my time during business ours. I trust this reasonably will address everyone's needs on these items.

I believe this encompasses our entire agreement.

Lisa, please take a look at all this. If I've got something wrong, please respond to this and point out the problem within the next two days. Otherwise, I'll reject my other opportunities and be ready to start work in 30 days. If you'd like a more formal employment agreement, I'll be happy to have my lawyer draft one. I am excited about the company's prospects and about your enthusiasm for pursuing my ideas.

Best personal regards,

It goes without saying that what your letter says was agreed had better be what was agreed. If there's something that wasn't discussed, but is important to you, just say that. Be honest. Tell them what it is and what you need. Tell them what they need. Or if you don't know, then ask. And propose something reasonable that meets both sides' reasonable needs and expectations under the circumstances. Remember that it's about getting your due compensation and simultaneously building a great relationship by giving them what they need.

The above example is fairly detailed and involves the big job at a middle-market company. More realistically, for a job this big, the company will deliver an actual written contract prepared by its own lawyers. Whenever you make any deal, it's generally an

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advantage to have your own lawyer do the first draft of the agreement: That draft document normally will frame the discussion going forward. Generally, the employer will take this opportunity for itself. You won't get this opportunity in the employment context unless you work for it.

In many cases, especially with smaller jobs, you'll get nothing but an oral agreement — including a lot of representations that they probably do not intend to be held to in any strict sense. Because you have to make a decision based on those representations, you need to know whether you can rely on them. This kind of letter, and your prospective employer's response, will tell you whether they meant what they said.

Many employers will be a little surprised. Some may be put off — because they do not want to deal with an employee sophisticated enough to do this. If this happens, emphasize that you are certainly not trying to dictate terms. You're a team player, and you want to make certain everyone has the same vision. If they want something different than what was in your letter, or if there's something important that they can't be sure of, you just want to know about it and have it out in the open. Anyone worth working for will find this reasonable. Anyone who rejects this approach is not someone you want to work for.

If you can get “Lisa” (in my example) to respond to this letter and confirm her agreement, even in part, you've at least eliminated disputes as to those items she confirms. A simple “that's what we discussed” from Lisa means you've got a pretty good written contract.

Of course, a “fully lawyered” version is even better, as described below.

If you get an offer letter where they're specifying the terms to you, then you can use the same basic technique to respond. Just write back saying that before signing the letter you wanted to confirm that a few items not addressed in the letter were in fact part of the deal, or to clarify a few points that were a little unclear from the letter. Then lay them out and ask for confirmation. Again, if someone says yes, that's part of the deal, then you've got the terms you want, all you need to do is sign their offer letter with the notation like “as amended by my letter to Lisa of June 10, 2002.”

One final comment before we jump into a more detailed look at employment contracts. You may have noticed that many formal contracts have something called an “integration clause.” That clause says, in essence, that the document in question contains all the terms of the deal and nothing that anybody said anywhere else is part of the deal. You'll see clauses like: “This agreement reflects the complete agreement of the parties with respect to its subject matter.” That's what this clause does.

Although I address these clauses below, it is important to consider them in the context of confirming letters. Only if you include a clause like this (you'll notice I slipped one into the exemplar) are you protected against someone saying: “Well, yes but we also said that if sales fell below this level we'd be entitled to terminate you without severance,” at which point you'd have little left besides a lawsuit where a jury decides whether you or your boss is lying about what was said. It's a lot cheaper to write the deal down clearly at the beginning in an enforceable form, and confirm in your letter or

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contract that all the terms are written there — so no one can later claim that additional or inconsistent things also were agreed.

## **A CRASH COURSE IN EMPLOYMENT CONTRACTS**

### **I. INITIAL CONSIDERATIONS**

#### **Responsibility and Authority**

Your employment contract must precisely describe your responsibilities and grant you all the authority and resources you need to fulfill them. Your duties should be described in as much detail as possible. The more general the recitation of responsibilities and authority, the more flexibility your employer will have to change and manipulate your job later on. Any failure to spell these out invites frustration because your job may be less than you understood or impossible to fulfill.

If your employer is not willing to do that, don't take the job. You are being set up to fail. I recommend that you instead set yourself up to succeed by getting the authority and resources you need promised up front, in writing. Agree on exactly what authority and resources are required. If possible, agree on specific goals.

Request that the agreement state that a demotion or significant reduction in responsibility or authority will constitute a breach of the agreement.

Also, get as much freedom as possible to accomplish those goals without interference. You can always get advice, but the freedom to win ensures you aren't prevented from succeeding. Be willing to succeed or fail on your own. You'll get blamed if you fail, so you may as well position yourself to get credit for your successes.

#### **Due Diligence (Doing Your Homework)**

If you were to buy a business you doubtless would inspect its facilities, review its financials, talk to its board of directors, officers, employees, customers, and competitors, analyze its capital structure, analyze the industry, evaluate the integrity of the owners, and otherwise make sure you knew what you were getting into before you parted with your money or the money of anyone who was relying on you to make sure the investment was prudent.

Treat your time with the same respect. Given the nature of employment, you're not just investing your time, you're also taking career risk. So like anyone making a big investment, you'd better conduct some due diligence. Do all the things I described above. Further, as an employee you may receive compensation in options, bonuses, or profit sharing. In any of those cases, your pay depends on the company's performance. In the case of equity deals (where part of your pay is in shares of stock or options to buy shares), you'll need to know what rights you're really getting. So review the company's by-laws, articles of incorporation, operating agreements, partnership agreements, organizational charts, option plans, financial statements, option grants, contracts, press releases, advertising, executive speeches, financials, and public filings. Doing this will help you identify and obtain the right job. It will help you avoid being fooled and feeling foolish.

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Your employer may not want to give you some of this information. Very few employees are careful enough to look at this material, so your requests may be uncommon, or even unheard of to him. But if part of your compensation is equity, options, or warrants then you definitely need it and are entitled to it. If they refuse to give it to you, they're hiding something.

### Representations and Warranties

Agreements for the purchase of a business generally include “representations and warranties” that restate specific material facts that each side is relying on.<sup>6</sup> The side that has produced that information promises that it is accurate, and the other side relies on this promise with the security that if it is not true then they at least have the comfort of a legal claim against the misrepresenting party. For example, the seller of a business generally represents and warrants that the company's financial condition accurately is reflected in the financial statements that were delivered to the buyer.

Employment agreements generally do not contain representations and warranties. Mine do, and it's the better practice.

If having done your homework you still want the job, you need to make sure the key facts you're relying on are part of the contract. If you can, get representations and warranties that the company's financial condition is as shown in the statements they gave you, that the articles and bylaws they provided to you are accurate copies of the company's governing documents, that if you meet the goals clearly defined in your contract you will get the promotion they indicated, etc.

The company may well ask you for representations and warranties. Commonly employees are asked to represent to the company that the employee is free to enter into the employment contract — i.e., you do not have any non-competition covenant or other legal problem that prevents you from working for the company or puts the company at risk by employing you. It is entirely reasonable for the company to request this from you. They're paying you a lot of money, letting their other candidates go, and do not want to find out in six months that you forgot to tell them about this one little problem that, as it turns out, means you can't work there. Similarly, you're entitled to confirm that they're on the up-and-up.

I expect that it will become common practice for companies to require that you represent and warrant the accuracy of the information on your resume or curriculum vitae. There are a lot of successful frauds out there, and companies are entitled to demand that you vouch for the truth of what you asked them to consider in deciding whether to hire you. If you're a liar, they're entitled to fire you. Just like you'll want to do when someone does it to you. In turn, the company should promise it's telling you the truth.

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<sup>6</sup> For those of you with a technical bent, there is a legal distinction between a representation and a warranty. A false representation gives rise to a claim for fraud or negligent misrepresentation. A breach of warranty gives rise to a breach of contract claim. If you're on the receiving end, you want to get both. If you're on the giving end, avoid making representations where possible. The other side generally will be satisfied with a warranty.

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### Risks, Rewards, and Insurance

There are always risks. In any business deal it is essential to identify the risks and negotiate who will bear them. Then apply the fundamental economic concept that whoever bears the risk should be compensated for doing so.

Let's take the simplest of examples: You're leaving a secure job at a big company for an exciting job with a start-up. You may get the same salary. For risking your career-path, and for accepting the risk that you may, somewhere along the line, miss a house payment, you'd better be getting enough in stock options to compensate you for taking this risk. This is simple common sense. Just remember that this concept applies in an infinite variety of ways, not just in this most obvious of examples. So identify all the risks.

Once you've identified the risks, there are an almost limitless number of ways to deal with them. You can negotiate who bears them, and whoever takes the risk should be compensated. Whoever winds up with the risk in the deal can, if they wish, pay a third person to bear it. That's insurance by any other name.

What risks should you consider? Is your prospective employer a start-up that's likely to be out of business in six months due to possible lack of funding? If so, are you being compensated for taking the risk of being out of a job and perhaps not even getting paid for the work you did? This is risk requiring compensation beyond what you'd be worth at General Motors or IBM, both of which are likely to be in business next year.

If you're not being compensated at a premium for assuming that risk, then perhaps you can get them to escrow your pay for the first year or two? I'm talking about requiring that the company put your total annual salary in an escrow account where the escrow agent will pay you if the company doesn't.

I actually saw this done once. A CEO got \$900,000 for two years salary escrowed as a condition of taking the job. And he needed it, as it turned out. If the company has the financial backing of people you know have the money, but the cash isn't in the business, you might want to ask for this, or for a personal guarantee from the people with the money. If they say they're backing the company, but refuse to provide the cash security or a personal guarantee, then maybe they're not that committed to the company after all. Of course, usually you get compensated for risk in small ventures by stock options. The point is, recognize it's a risk and ensure that you're either getting compensated to accept it, or shifting it to someone else, or "insuring" against it.

Of course, company failure is not the only risk. There are political risks — perhaps your prospective boss has a history of firing his second in command once a year and that's the job your up for. In this case, severance pay must be negotiated.

Once you've identified the risks, eliminate the risk you cannot afford and be sure you are being compensated for the risk you're taking. It's fine to work for a doubtful company if you're getting twice the pay. It's silly to work there if you're getting the same pay unless someone you've shifted the nonpayment risk for someone else/



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### Protecting Yourself

#### Indemnity

Mandatory or Discretionary  
Get it in the contract

#### Insurance

What is D & O Coverage  
Issues to Consider:

[taken from website on findlaw] **Most D&O policies exclude claims for acts of dishonesty and fraudulent or criminal conduct. These exclusions also raise a number of questions for officers and board members, including:**

- Are the D&O exclusions triggered by mere allegations of dishonest, fraudulent or criminal conduct? If so, the insurer will refuse to pay defense costs, even to a frivolous claim.
- Does the criminal conduct exclusion require proof of willful or merely negligent conduct?
- Does the policy exclude coverage of innocent officers and directors by imputing to them the wrongful knowledge or acts of others?
- Can coverage for the company's own liability be forfeited if an applicable exclusion applies to claims against an officer or director?
- Are the policy limits segregated to prevent them from being used to cover the entity at the expense of the individual officers and directors?
- Will a restatement of the company's earnings cause the D&O carrier to rescind or not renew coverage?

## II. COMPENSATION

### A. Cash Compensation and Benefits

#### Salary

1. Amount
2. Periodic Increases
  - a. Discretionary
  - b. Cost of Living Adjustment (COLA)
    - i. Tied to Consumer Price Index (CPI)
    - ii. Predetermined periodic rates of increase
3. Frequency with which it is to be paid (weekly, bi-monthly, etc.)
4. Provision for tax withholding

#### Bonuses

1. Discretionary Bonuses

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- a. At whose discretion?
  - b. Obligations to review company's success and executive's individual contribution to that success (entitlement of executive to written statement outlining grounds for setting bonus at particular level or not granting it)?
2. Company Performance Bonuses
- a. Bonus Contingent upon company achieving given level of profits in a given year (i.e., \$20,000 bonus if profits exceed \$1 million).
  - b. Bonus as percentage of profits in excess of \$XX (i.e., 5% of profits in excess of \$1 million)
  - c. Specify how profits/base amount are defined
    - i. Gross Sales
    - ii. Gross Profits (gross sales less cost of goods sold)
    - iii. Operating Profits (profits after operating expenses)
    - iv. Profits after dividends, taxes, or other specified deductions
    - v. Net profits (gross profits less all expenses)
  - d. Specify document used to establish base amount (i.e., annual financial statement prepared by employers CPA, taxable income on employer's annual tax return).
  - e. Method of adjustment for uncollected payments, returns, etc.
  - f. Does executive have right of access to relevant financial records to verify accuracy of size of bonus?
  - g. Group bonus fund awards
    - i. Employer puts certain percentage of profits, sales, etc in fund
    - ii. Who is entitled to fund and how is it divided up?
      1. Preset percentages (i.e., relative to salaries of all executives involved)
      2. Discretionary?
3. Individual Performance Bonuses
- a. Formulaic bonus tied to yardstick specific to executive involved (i.e., sales volume for vice president of sales)
  - b. Attainment of some non-numeric predetermined goal (i.e., reorganization of a particular branch/division, consummation of a merger, etc.)
4. Target and Proportional awards (bonuses need not be all or nothing)

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- a. Basic bonus level (\$50,000 bonus if gross sales hit \$50 million)
  - b. Schedule for proportional amount
    - i. Ramp up to \$100% from \$40-50 million
    - ii. Up to more than 100% for sales in excess of \$50 million?
5. Miscellaneous bonus provisions
- a. Floor or ceiling amount if done as percentage
  - b. Time and method of payment
    - i. Lump sum
    - ii. Installments
      1. Provision for whether payment will continue in event of:
        - a. Termination
        - b. Death
        - c. Disability
        - d. Breach of covenant by executive
        - e. Transfer of interest (voluntary/non-voluntary) in right to receive (i.e., garnishment, attachment, etc.)
        - f. Insolvency, termination or sale of employer's business
6. Signing Bonuses

## B. Executive Benefits

### Standard Fringe Benefits

1. If employer has substantial fringe benefit packages available to all employees, executive will typically be entitled to receive the same standard packages. The executive's eligibility for these benefits should be referenced in the contract. Examples of these standard benefit packages are:
  - a. Pension/retirement plan
  - b. Accident and health insurance/Self-insured or uninsured medical reimbursement plan
  - c. Dental plan
  - d. Eye-care plan

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- e. Group life insurance
  - f. Education expense reimbursement
  - g. Stock option/investing/savings plan
2. Mention special considerations with medical and (especially) life insurance.
  3. Executive should review these benefit packages and determine whether they meet his needs. If not, he should negotiate for additional benefits.
  4. Employer typically reserves the right to amend benefit plans at any time. Executive should consider requiring employer to stipulate in contract that benefit levels available to him meet certain minimum levels.

Additional Fringe Benefits – Executive employment agreements typically contain benefits in addition to those available to lower level employees. These additional benefits typically include:

1. Disability Benefits (sometimes included in standard benefit package, sometimes not)
  - a. “disability” should be specifically defined. Usually framed in terms of inability to perform services for a prescribed period of time due to illness, injury, incapacity, etc.
    - i. Prescribed period of time should be set (i.e. 2 weeks, 6 months, etc.)
  - b. Fixed amount of disability payments (or formula for determining same) should be specified.
  - c. Duration of disability payments should be specified.
  - d. Is disability that continues beyond prescribed time frame grounds for termination for cause?
2. Death Benefits (as distinguished from life insurance). Four main considerations.
  - a. Amount payable (first \$5000 is tax exempt)
  - b. Who is beneficiary – contract should specify procedure for changing designated beneficiary.
  - c. Time period after death within which benefit to be paid.
  - d. Is benefit payable if executive dies during retirement?
3. Relocation Benefits – Important if new position requires relocation or if nature of job is likely to require periodic relocation. Of special concern to multinational executives (or executives of multinational companies). Structure of relocation benefit package will depend on whether relocation is temporary or permanent.

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- a. Most important decision is what to do with executive's current principal residence (assuming he owns it). This will often turn on whether relocation is temporary or permanent, but other factors should be considered. Executive should look at real estate market. If prices are going up, and are expected to continue to rise, selling may not be a wise choice even if relocation is expected to be permanent. Instead, executive should consider renting the residence he owns now, and (assuming he cannot afford to buy a second residence in his new location) use the proceeds from that rental to rent a residence in new location.
  - i. Renting – If executive chooses to rent (because relocation is truly temporary (i.e. foreign service assignment for specified period of time) or because he wants to hold on to his real property as an investment), it is typical for employer to provide an allowance for reimbursement of cost to retain a real-estate broker or property manager to find tenants and manage the rental property.
  - ii. Selling – Employers typically provide reimbursement for brokers fees, taxes, surveying and closing costs, etc. Executive may be able to negotiate for sale price protection (employer pays executive difference between appraised value of home and sale price if home is sold at a loss). Sale price protection is a reasonable request because the loss would not have been incurred if not for the relocation. But many employers balk at this and consider the sale of the home a personal investment decision for which the employer is not responsible. In many cases, it is common for employer to purchase house from executive at appraised market value (and then resell it on its own) to speed things along.
- b. Reimbursement for visits to new location – it is usually necessary for executive and spouse to visit new location one or more times for purposes of house and school hunting, etc. Employer will often provide reimbursement for air travel, accommodations, and other expenses. The types of expenses that qualify for reimbursement should be specified (economy or business class, costs of accompanying children, etc.). If employer has a standard policy, executive should familiarize himself with that policy so that there are no surprises.
  - i. Tax issue: Relocation benefits must be included in gross income for tax purposes subject to only a qualified moving expense reimbursement exception. Qualified moving expense reimbursements are limited to the cost to move household goods and personal effects and the cost of the actual trip to move to the new location. This means that the

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executive must pay taxes on the value of all other relocation benefits provided such as pre-move trips, temporary living quarters, costs incurred in connection with selling, buying or renting, etc. As a result, the executive may seek for relocation expenses to be “grossed up” by a percentage equal to the tax rate that will be applied to the reimbursements (the highest tax rate applicable to executives income).

- c. Relocations necessitated by temporary foreign service assignments – there are special considerations for executives of multinational firms who may be required to take foreign service assignments. Where such an assignment is implicated or anticipated, the executive should be especially concerned with:
  - i. compensation in terms of differences is the cost of living and/or housing in the foreign location
  - ii. tax equalization (executive wants his after tax compensation to be at least as high in new location – many European countries have significantly higher tax rates than the United States)
  - iii. Dependent education – employer customarily reimburses (at least to some degree) for education expenses for kids incurred abroad – kids unlikely to be able to attend public schools, especially due to language barriers.
  - iv. Home leave – set off against or in addition to vacation time. Same issues apply as with vacation time (accrued or not, etc). What about costs incurred in travel (airfare, etc.)?
4. Below-Market Loans – On hold – find notes, talk to Ray
5. Payment of Executive’s professional expenses
  - a. Malpractice insurance – specify policy amount limits. Is employer responsible for indemnifying executive for liability above policy limits?
  - b. Professional association dues – specify what dues are to be paid.
  - c. Expenses incurred to attend seminars and conventions – are there limits to what expenses will be reimbursed? Is there an overall cap on amount to be reimbursed?
6. Perquisites – Perquisites, or “perks,” encompass all of the miscellaneous items of compensation that find their way into executive employment agreements. Some common perks include:
  - a. Company cars
  - b. Annual physicals

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- c. Access to on-site athletic facilities
- d. Club memberships
- e. Financial Counseling
- f. Entertainment allowances

The executive should bear in mind that the value of these perks must be included in his gross income for tax purposes unless the perk is specifically excluded from gross income by IRC 132 (qualified transportation fringe exclusion, financial counseling excluded if non-discriminatory, on site athletic facilities excluded).

### Severance Pay and Liquidated Damages

1. Where an employment agreement has not set duration, or can be terminated at anytime by the employer, a provision for severance pay should be procured to protect against the executive's risk of finding himself without a job.
2. Severance pay is sometimes treated as a form of deferred compensation providing a stream of payments to executive following the termination of his employment. Severance plans can even be the subject of company-wide benefit packages with the amount of the severance benefit tied to the number of years of service with the company.
3. Employment contracts are usually drafted such that the event triggering the severance is termination by the employer without cause.
4. Severance pay can be properly conceived of as liquidated damages. It is an estimation of the amount in which the executive will be damaged by the employer's breach of the agreement. Thus even where there is a stated term of the agreement providing for termination only for cause, it is common for employment contracts to state that where the employer terminates without cause, the executive will be entitled to a specific amount of severance pay.
5. Employers are likely to require the execution and delivery of a release, releasing employer from all legal claims executive may have against it as a condition to receiving severance pay.
  - a. Nit picky legal issue: Federal Age Discrimination in Employment Act of 1967 – to effectuate a valid waiver of rights under ADEA, compliance with certain waiting periods and procedures is required. The agreement should state that severance pay will be condition on compliance with such procedures and that payment will be deferred during all applicable waiting periods.

### Expenses

1. Most executive employment agreements provide for reimbursement to executive of expenses incurred in the normal course of his duties. The

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employment agreement should specifically identify which expenses will be reimbursed. Typical reimbursed expenses include:

- a. Travel costs (airfare, business related car or train expenses, etc)
  - b. Meals and lodging while on the road.
  - c. Entertaining current and prospective clients.
2. An easy way of accomplishing reimbursement for expenses is by providing executive with company credit card. Where this is not the case, and executive must spend his own funds and be reimbursed, the terms of such a process should be outlined (ie. Reimbursement monthly or quarterly, how to go about getting reimbursed).
  3. Employers typically require executives to thoroughly document expenses (with receipts, credit card statements, cancelled checks, etc). The contract should state what documentation is required, and if there will be no reimbursement absent adequate documentation, the contract should so state that fact.
  4. Often, employer will have a standing policy governing expense accounts. This should be incorporated by reference into the contract, and executive should familiarize himself with policy.
  5. If the executive is required to spend his own funds for the benefit of the employer, and is not to be reimbursed, the contract should state this explicitly to facilitate deduction of expenditures for tax purposes.

Publicity – On hold – Talk to Ray

Paid Vacation – 4 main considerations

1. How much – specify amount of time (i.e., 4 weeks, 10 business days (if defined in business days, define business days)).
2. Requirement of prior approval/notification of employer. How much notice (in terms of time) is required. Employer has reasonable concern for coordinating work schedules and avoiding understaffing at various times.
3. Accrual – Does unused vacation time carry over to following years, or is it lost. If scheduling of vacations is likely to be difficult, executive should try to insist that vacation time be accrued.
4. Vacation pay – may executive choose to forgo vacation time and take vacation pay. If employer refuses accrual, vacation pay for used time is the next best thing. Ideal situation for executive is to allow for accrual with executive's option to convert to pay at any time.

## D. Stock Options and other Equity Interests



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1. ISO's
  - a. Tax Benefit
    1. Neither grant nor exercise of option is a taxable event. There is no income tax liability until the shares acquired under the ISO plan are sold. Thus tax deferral is achieved – tax paid at later date is cheaper than tax paid now.
    2. Tax rate is favorable capital gain rate – currently a maximum of 15% instead of rate applicable to ordinary income (currently 35%)
  - b. Statutory Requirements
    1. Must be part of a valid plan of offering (approved by shareholders etc. – usually not a concern to the executive)
    2. Ten year limitation for grant – options must be granted within ten years of establishment of plan – again usually not a concern for executive
    3. Option price – must be at least equal to fair market value at time of grant of option for publicly traded corporation. For close corporation, good faith effort must be made to
2. NQSO's

Lock-Ups and other Restrictions on Transfer

Quasi or Shadow Equity

Deferred Compensation

1. Benefits of deferring compensation
  - a. Allows for tax-deferred accumulation of assets for post-retirement years.
    - i. Not as big of a deal now as it was when tax rates were as high as 70%.
2. Qualified plans like 401(k) often don't meet the needs of highly compensated executives due to non-discrimination and other limitations on those plans.
3. Non-qualified plans are purely contractual, and if unfunded (not secured by trust arrangement or insurance) allow for tax deferral. Plan must be a mere promise to pay in the future, and executive is a mere general creditor of corporation. If it appears that executive is more than a mere creditor (i.e. there is an annuity contract or he is holder of insurance policy), then there is constructive receipt of funds and tax liability is imposed unless there is substantial risk of forfeiture of right to payment.

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- a. Since unfunded, there is always risk of non-payment – executive can protect himself by purchasing a bond against the contract right – or can negotiate for accelerated payments in event of financial distress of employer.
  - b. Executive should insist on provision for payment to a beneficiary in event of death (can be lump sum or payment continuing as it would if still alive).
  - c. Employer doesn't get to take deduction until the compensation is actually paid to executive. This sucks for employer, but he still likes it because if deferred compensation is tied to performance, then it continues to provide long-term incentive for good performance. Employer can even fund the plan, say with an annuity contract that conditions the executive's right to receipt of annuity (say, beginning at retirement) on continued good performance (i.e., there can be a provision for forfeiture in event sales don't increase by 5% each year). There is probably substantial risk of forfeiture, so even if funded, no immediate tax liability for employee
  - d. Rabbi Trust – quasi funded plan that allows for tax deferral for executive. Employer funds trust that remains subject to general creditors but trust expressly precludes return of assets to employer
4. Structure of Executive Deferred Compensation Plans
- a. Specified Amount (lump sum, defined installments for defined period of time)
    - i. Contract should state the date upon which payment begins (i.e., upon retirement or a specified date of the year after retirement)
    - ii. If payments continue for life of executive, contract should specify that employer's obligation to make payments ceases upon executive's (or spouse's) death. Employer may require cap on total length of payments (i.e., no more than 20 years).
    - iii. Payment may be conditioned upon:
      1. Rendering of consulting services during retirement.
      2. Continuing observance of restrictive covenants.
  - b. Incentive arrangements
    - i. Profit Sharing
    - ii. Phantom Stock
    - iii. SAR's

## Tax Considerations

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Company concern: Pay exceeding \$1,000,000 Not Tax Deductible  
IRC §162(m)(4)

### Term

For some very compelling reasons, Courts have a strong disfavor of involuntary servitude. From the earliest English common law decisions, courts have consistently restated the rule that no employee can be compelled, against his will, to remain in the personal service of another.<sup>7</sup> (This seems like a good rule to me, and, as I will discuss later, will have some further implications in the event that you or your employer breaches the employment contract). Consequently, an employer is under no obligation, against his will, to retain an employee. What's fair is fair, right?

As a result, absent a contract for a definite period of time, an employer can discharge an employee at any time for any reason (or even for no reason at all).

While this solves the problem of involuntary servitude, and on its face gives the appearance of being fair to both employee and employer, in the context of executive employment, it often does not provide the security that both parties need. On one hand, your new employer doesn't want to have to go through the process of filling your position all over again. More importantly, after going through the job search process yourself, making life-altering changes, and maybe even relocating your entire family, you need to know that you're going to be around a while.

Consequently, from an executive's perspective, the most significant aspect of an employment contract is often the term, or length of time that he or she will be employed. It is very common for an executive employment agreement to include a stated term, and if it is at all important to you, you should insist on one.

The appropriate term in any given contract will always depend on the circumstances involved. The ideal term for the executive will be one that is long enough to give him the security he needs but so long as to keep him locked into a job that is no longer right for him. If you have the bargaining power, try negotiating for a short fixed term with an option to renew. That way, you will be guaranteed employment for an extended term, but will be able to get out early if things aren't working out.

Of course, if a long-term contract has locked you into a job that is not working out, it is usually in the employer's best interests to let you leave. An unhappy executive typically does not perform very well, so an employer is unlikely to discourage one from leaving by threatening legal action. Because it is far less risky for an executive to breach an employment contract than for an employer to do so, a long contract term usually inures to the benefit of the executive.

-- What happens when executive keeps working past term? The relationship of parties past term should be detailed (at will? Renewal for new entire term?) – one

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<sup>7</sup> In this country, the rule was definitively stated by the U.S. Supreme Court in the case of *Adair v. United States*, 208 U.S. 161 (1908)

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solution – automatically renewable 1 year terms unless written notice given by either party

### Termination

#### For Cause:

A stated term standing by itself will often not be acceptable to the employer. Just as you need to know that upon accepting a job offer, you will be guaranteed employment for a stated time period, your new employer needs to know that he is not guaranteeing employment without the ability to terminate in the event of unsatisfactory performance. Simply put, your employer needs to know that notwithstanding the stated contract term, if you don't do your job, he can fire you.

The typical solution to this problem is the insertion of a provision in the agreement allowing termination by the employer "for cause" prior to the end of a specified term. Exactly what will constitute "cause" will be a matter of substantial negotiation between the parties, and a well drafted executive employment contract will need to be as specific as possible in outlining what will and will not constitute "cause."

Make sure you and your employer are in complete agreement as to what conduct or circumstances will allow for early termination. Where possible, use objective criteria, i.e., if sales levels fall below a certain number, then the employer will have cause to terminate. The vast majority of disputes that arise out of employment contracts center on whether termination was with or without "cause."

If an employer insists on being able to terminate without cause despite a stated term, the executive should protect himself by negotiating for severance pay in the event that he is terminated without cause.

#### Death and Disability (talk to Ray):

Termination without cause – executive get to continue to receive salary and benefits?

Effect of termination (especially on non-competition and non-disclosure agreements)

### Change of Control and Golden Parachute Provisions

#### Assignment (Termination on)

(dissolution, combination, sale of assets, change of control)

### Outside or Full Employment/ Reasonable Time and Effort

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### Non-Competition, Non-Disclosure, and Non-Solicitation Clauses

Post employment employment and entrepreneurship

### Intellectual Property

1. What is IP?
2. Copyrights
  - a. Tangible expression of ideas – takes effect upon creation of the tangible thing
  - b. Default rule – very favorable to employer
  - c. Can be changed by contract, but employer unlikely to agree – if employee expects to create copyrightable material outside of employment, the contract should state specifically what he intends to create and that he retains ownership of the copyright for those items.
3. Patents
  - a. Inventor of new/useful process, etc. gets limited legal monopoly on it.
  - b. Default rule – not as favorable to employer. Employer owns only if employee hired for the purpose of designing the thing invented.
    - i. Shop Rights – regardless of who owns the patent, employer may be entitled to royalty free use of the invention/process if developed by employee in the course of employment.
  - c. Employer will try to contractually alter default rule. If you can, don't let him.

### Arbitration and Mediation

### Jurisdiction, Venue, and Choice of Law

### Attorney's Fees

### Fax Signatures, Multiple Originals, Notaries and mere Confirming Letters

### How Do I Know If I Need a Lawyer?

### The Whole Deal (Integration Clauses)

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CONCLUSION (So what I'm saying is . . . .)