

# FENG Workshop

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## Negotiating and Structuring Executive Employment Arrangements

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# Carmody MacDonald

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Carmody MacDonald P.C. is a full-service law firm dedicated to serving clients as a valued counselor and champion of their goals. Founded in 1981, we are focused on building close relationships with clients and providing premium quality yet cost-effective legal services.

Carmody MacDonald P.C. serves clients in a wide variety of areas including general civil litigation, real estate litigation, medical malpractice defense, toxic torts, banking and finance, commercial real estate, closely held business, estate planning, taxation, and domestic relations, among others.

We take pride in our spirit of collegiality that enables us to easily coordinate among our many areas of expertise to provide legal services addressing virtually every realm of corporate and individual needs.

# Brian C. Behrens

## Principal

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- **Areas of Practice**

- Business Law
- Venture Capital
- Real Estate Law
- Employment Law and Counseling

- **Education**

- Saint Louis University, J.D., cum laude, 1995
- Staff Member, Saint Louis University Public Law Review
- Saint Louis University, M.B.A., 1995
- University of Missouri-Columbia, B.S.B.A., cum laude, 1991

- **Professional Organizations/Community Service**

- Association for Corporate Growth
- Missouri Venture Forum
- Member of Cardinal Glennon Children's Medical Center Development Board

# Mark B. Hillis

## Principal

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- **Areas of Practice**
  - Banking
  - Closely Held Businesses
  - Commercial Finance
  - Commercial Real Estate
  - Private Equity Placement
  - Employment Law and Counseling
- **Education**
  - University of Michigan Law School, Ann Arbor, Mich., Order of the Coif, 1972
  - Stanford University, Stanford, Calif., B.A., Political Science and Economics, 1969
- **Professional Recognition**
  - For more than 10 years, he has been listed in The Best Lawyers in America (Real Estate Law)
  - Named one of St. Louis' Best Lawyers by St. Louis Magazine in 2006, 2007 and 2008
  - Missouri "Super Lawyer" in 2005, 2006 and 2007

# David H. Luce

## Principal

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- **Areas of Practice**
  - Civil Litigation
  - Real Estate Litigation
  - Business Litigation
  - Commercial Litigation
  - Employment Litigation and Counseling
- **Education**
  - University of Kansas School of Law, Lawrence, Kan., *Order of the Coif*, 1986
    - *Law Review*
    - *Criminal Law Review*, associate editor
    - Academic Achievement Awards: Civil Procedure, Evidence, Trial Practice and Torts
  - The Ohio State University, Columbus, Ohio, B.A., English, 1983

# Negotiating and Structuring Employment Arrangements

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- Overview:
  - Survey of Common Issues
  - Summary of Missouri law
  - Executive Employment Agreement
  - Enforcement
  - Due Diligence – Before the Hire/Acceptance
  - Do's and Don'ts on Termination of Relationship
  - Q&A (throughout workshop)

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## Executive Employment Survey

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- 1. Non-competition clauses are not enforceable under Missouri law. True or False?**
- 2. At an annual meeting, an employer advises all employees that they will need to sign agreements containing confidentiality, non-competition, non-solicitation clauses. No additional compensation is offered to the employees. Will the agreement be enforceable?**
- 3. If an employer terminates an employment relationship, the employee is released from any and all restrictive covenants. True or False?**

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## Executive Employment Survey

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4. **In a typical employment relationship, what is the maximum number of years that Missouri courts have found to be reasonable for non-competition covenants?**
  - A. 2 years
  - B. 5 years
  - C. 10 years
  
5. **Employers can avoid having to withhold taxes or provide benefits to an individual by categorizing him or her as an independent contractor. True or False?**
  
6. **As part the negotiations concerning potential employment, an employer advises an employee that it would like to provide the employee an equity interest in the company after two years as additional compensation. The Employment Agreement is subsequently entered into by the parties, but does not contain any provisions concerning the equity interest. Can the employee enforce the promise of the equity interest?**

# Summary of Missouri Law

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- At-Will state
- Contract of Employment enforceable
- Discrimination, harassment and retaliation issues

# Points of the Employment Relationship

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- Term
- Termination
- Cause

# Termination of Employment

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- By employer “for cause”
  - absence from work;
  - failure to perform and responsibilities;
  - material breach by the Employee of the agreement;
  - the Employee’s commission of fraud or dishonesty against the Company, or willful misfeasance or nonfeasance of duty intended to injure or having the effect of injuring the reputation, business or business relationships of the Company; or
  - A charge against the Employee of any crime involving moral turpitude, fraud, etc. or which could reflect unfavorably upon the Company.

# Termination of Employment

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- By employee “for good reason” (e.g., material change in salary, duties or title)
- By either employer or employee without cause
- Employee receives post-separation benefits if terminated without cause or if terminated by employee for a good reason
- Terminations by employer with cause or by employee for no good reason generally leave employee without post-separation benefits
- Separation, severance, waiver and release agreements can supply additional post-separation benefits and obligations

# Points of the Employment Relationship

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- Salary
- Deferred compensation

# Section 409A

**(Fully effective as of January 1, 2009)**

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- Generally governs any arrangement under which an employee can be paid in a year after the year in which the employee obtains a legally binding right to the payment (a nonqualified deferred compensation plan).
- Applies to all companies, employees and independent contractors -- at all levels.
- Employment agreements, bonus programs, split-dollar life insurance, severance policies, deferred compensation plans, change in control agreements, and equity plans are potentially subject to Section 409A.
- Plans and payments that fail to comply are fully taxable in the year employee obtains a legally binding right to the payment.
- Imposes a 20% penalty on the noncompliant amount and an additional 1% underpayment penalty on employee, in addition to regular taxation and underpayment penalties.
- Employer may be subject to penalties for failing to withhold proper amounts for taxes.

# Points of the Employment Relationship

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- Benefits
- Performance Evaluations
- Amendments
- Work Product

# Confidentiality Provisions

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- “Confidential Information” is all technical or business information that is of a confidential, trade secret, and/or proprietary character, including without limitation:
  - a. the company’s business, products, costs, margins, etc;
  - b. customers or suppliers (and information concerning actual or prospective transactions ); or
  - c. inventions, discoveries.
- Confidential Information may or may not be labeled as “confidential” but employee will treat all information that is not obviously public knowledge as confidential unless otherwise instructed.
- At termination of employment or at any other time upon the request of the Company, Employee shall promptly deliver to the Company all documents and other materials containing Confidential Information.
- Employee agrees that the damages resulting from any breach of the confidentiality agreement may be intangible and that the Company is entitled to seek specific enforcement, injunctive relief and other equitable remedies in addition to monetary damages and legal remedies.

# Points of the Employment Relationship

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- Non-Solicitation
- Non-Competition
- Specific agreements vary widely and are industry and employee specific

# General “Non-Compete” Agreements

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- To be enforceable, the agreement must:
  - Protect only “legitimate interests” of employer
  - Be reasonable in scope (subject matter, time and geographic reach)

# Employer's Legitimate Interest

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- Trade Secrets/Confidential Information
  - Compiled by employer, kept confidential, creates competitive advantage
- Customer contacts
  - The influence the employee acquires over employer's customers through personal contact; good will

# Kinds of “Non-Competes”

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- Non-Compete
- Non-Solicitation of customers
- Non-Solicitation of employees
- Non-Disclosure of Trade Secrets
- Non-Disclosure of “Confidential Information”

# Non-Solicitation of Employees

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- Promise not “to solicit, recruit, hire or otherwise interfere with the employment of one or more employees” is enforceable if:
  - Duration is for not more than one year
  - Employee provided more than secretarial or clerical services

# Scope – Depends on the Circumstances

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- Generally: nature of the business, interests for which protection is sought, extent to which clause is tailored to both
- Subject matter: “any job in any business that is competitive” vs. specified job duties/specified industry sector

# Scope

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- Time: Should be tied to period during which employee's good will is subject to appropriation – the “vulnerable period.”
  - 8 years longest on record (seller of business)
  - 5 years outer limit
  - 2 -3 years, most common
- Geographic: Must be related to particular field/business and employee's duties (e.g., national sales rep vs. local doctor).
- Time and Geography related: e.g., longer term on smaller area may be enforced.

# Trade Secrets and Confidential Information

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- Time limitations may be longer
- True Trade Secrets can NEVER be disclosed (formula to Coke)
- Confidential information should remain confidential as long as employer treats it so and as long as it retains value

# Enforcement Tools

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- Temporary Restraining Order
  - Probability of success on the merits
  - Threat of irreparable harm
  - Balance of litigants' interests
  - Public interest
- Preliminary Injunction
- Permanent Injunction

# Lawsuit

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- Breach of Contract
- Interference with contractual relations
- Injunctive relief
- Damages
- Attorneys' fees

# Particular Issues

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- Customers/Employees who follow without being asked
- Still at-will?
- Employer's prior material breach of contract
- Arbitration vs. suit
- Blue Pencil
- Sale of Business/highly compensated executives

# Due Diligence for Prospective Employers

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- Is employee bound by restrictive covenants?
- If so, will employee warrant her compliance with those covenants?
- Should prior employer be contacted?

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## Executive Employment Survey

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1. **Non-competition clauses are not enforceable under Missouri law. True or False?**

A: False, while such clauses are not generally favored, they are enforceable to the extent reasonable necessary to preserve an employer's legitimate protectable interest.

2. **At an annual meeting, an employer advises all employees that they will need to sign agreements containing confidentiality, non-competition, non-solicitation clauses. No additional compensation is offered to the employees. Will the agreement be enforceable?**

A: Generally, yes. Missouri courts have found that continuation of employment is sufficient consideration to make the agreement enforceable as long as the employer can show a legitimate protectable interest. Recent cases, however, have questioned such rulings and may indicate a new trend.

The questions and answers above are for illustrative purposes only.

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## Executive Employment Survey

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3. **If an employer terminates an employment relationship, the employee is released from any and all restrictive covenants. True or False?**

A: False, unless the employer materially breaches the terms of the employment agreement (i.e. No grounds for termination for cause per the Agreement, assigning an employment agreement without consent, etc.).

4. **In a typical employment relationship, what is the maximum number of years that Missouri courts have found to be reasonable for non-competition covenants?**
- A. 2 years
  - B. 5 years
  - C. 7 years

A: 2 years in a typical employment arrangement. A longer period may be applicable in other circumstances (i.e., the sale of a business, additional consideration is paid to compensate an employee to agree not to compete for a longer term, etc).

The questions and answers above are for illustrative purposes only.

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## Executive Employment Survey

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5. **Employers can avoid having to withhold taxes or provide benefits to an individual by categorizing him or her as an independent contractor. True or False?**

A: False. The IRS can recharacterize the relationship as one of employer-employee if sufficient control over the individual exists (the IRS 20 factor test).

6. **As part the negotiations concerning potential employment, an employer advises an employee that it would like to provide the employee an equity interest in the company after two years as additional compensation. The Employment Agreement is subsequently entered into by the parties, but does not contain any provisions concerning the equity interest. Can the employee enforce the promise of the equity interest?**

A: No. Unless the employer renews the promise to provide the employee with an equity interest after the Employment Agreement is entered into, all discussions, negotiations, and promises relating to the employment relationship will be superceded by the express terms of the Employment Agreement.