

TALENT STRATEGIES UPDATE



2009-2

International Association for Corporate & Professional Recruitment

Executive Incentives and Protections in Today's Economy



Recently we sat down with
Robin Bond,
Esquire, Founder
of the
employment law
firm Transition
Strategies, LLC

(www.transition-strategies.com), who throughout her 23-year career as an attorney has been actively involved in thousands of deals and provided direction to companies about contracts, policies and hiring and firing. Today's corporate culture of mergers, acquisitions, downsizings and whirlwind personnel changes, combined with new government oversight, has had a profound impact on hiring agreements, contract renegotiations and severance packages. How do you structure comp packages that attract quality executives and help retain your top talent?

Robin, can you start by talking about the general trends you're seeing in the marketplace?

Bond: I'd call it a frozen market in many ways. It's no surprise that companies are

using more independent contractors, are taking longer and longer to fill jobs - and are more thoughtful about whether they really need the position, at what level and whether the responsibilities can be divided and handled by existing employees. If they do decide to make a new hire, they have to be confident that the executive can hit the ground running, addressing the company's needs immediately with little or no learning curve.

On the employee side, candidates fear that the company that they choose to go with today may not be in business tomorrow. Are the financials really that strong? Will the job still be there six months from now?

To all of this, you need to factor in government oversight. Even if you aren't a company that has accepted TARP money, you're smart to do a careful overview of your comp policies so that you're in line with public expectations and can avoid future criticism.

All this means that in terms of contracts now being negotiated, employers are keeping a tight rein on relocation costs and signing bonuses - and, in many cases, employees are being asked to repay these if they leave the company within a two-year period. Equity is no longer the incentive it used to be - fewer employers are offering it, and executives no longer perceive this as an automatic avenue to wealth accumulation.



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Which perks have stayed in place - and what incentives are being offered?

Bond: Comprehensive medical, dental and vision coverage is still important, as is paid time off. More employers are opting out of the match to their 401Ks, so executives are looking for any supplemental retirement vehicles that fill the gap and don't attract unwanted scrutiny as being "excessive compensation." A good option is a portable cash-value life insurance policy paid for by the company but that executives can take with them when they leave.

Disability insurance is also an extremely valuable benefit, especially if it too is made portable, as well as long-term care policies. We haven't seen a lot of these long-term care policies yet as perks - but I am sensing that they are becoming more attractive as healthcare costs escalate and as executives age.

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In this economy, too, top-level executives are concerned that they're going to be sued for what they do in the course of their duties, and so directors and officers coverage is a critical component of the deal - plus assurance that if there's litigation, the company will pay the legal fees and advance any expenses.

What about incentive compensation like bonuses?

Bond: Certainly there is no hotter topic right now. I'm seeing more executives getting a

larger portion of their bonuses through deferred compensation or restricted stock units as opposed to immediate shares, as opposed to warrants, as opposed to plain stock options. Companies now have to carry stock options as expenses - and, in this economic environment, many senior executives want real cash in-hand now, versus betting on stock options later. Clawback provisions can also go into effect if the bonus is found to be based on inaccurate information.

A few companies are asking executives to work for a full year before they're bonus eligible - and some bonuses are paid pro-rata, based on goals actually achieved. This requires very specifically spelling out the expected results - and the bonus percentage tied to each objective. And, of course, TARP recipients shouldn't use TARP funds to pay bonuses.

You said relocation reimbursements are down?

Bond: I'm seeing a real reluctance to move executives in the first place - companies are asking, "Can we find the talent in-house or closer to home?" - especially given that a full relocation package could run \$80,000, maybe even more. And, realistically, many executives don't want to relocate; they are stuck with a house, or several houses, already that they can't sell, they're not sure how the job will work out, they don't want to disrupt their families or they simply fear they will lose too much with the current real estate market. Very few relocation packages - in fact, I haven't come across one in a long time - have companies buying houses outright as they may have in the past. So temporary living or rental assistance in the new location or weekly travel to and from the job for some period are very important components of the deal - as is getting a tax gross-up for relocation expenses.

Certainly, there aren't as many expatriate moves either as there were two or three years ago. I think many companies have decided that they're wildly expensive and are opting instead to hire local country talent. If that's not an option, the relocation expenses usually include renting, not buying, property; paid school for the children; and a certain number of trips home. But I am also hearing that more executives going overseas are negotiating for much shorter stays and choosing not to move their families.

What about severance in today's economy?

Bond: All executives are very concerned about what is going to happen in the event the company has to make cut backs. No federal law requires an employer to give an employee any amount of severance pay. It's strictly a matter of what an employee can negotiate with an employer, or what an employer voluntarily agrees per policy or practice to provide.

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What is reasonable for severance pay varies according to the specific circumstances. In general, the trend is toward six months of severance, rather than a full year. But you have to look at how long someone's worked for you, what's the level of the job, why you're letting them go. The important point, of course, centers on the employer's financial condition. You can have a promise of severance pay for three years, but if the

employer runs out of money, the severance obligation is considered an unsecured debt, and executives get in line along with all the other unsecured creditors to wait for payment - if they ever see it.

These new approaches seem to be direct products of the current economic environment. Can you talk a little about the impact government regulations are having?

Bond: This topic could fill an entire article in itself. Generally, the American Recovery and Reinvestment Act of 2009 (“ARRA”) has four major areas of influence on the workplace.

First, let's look at COBRA. Eligible individuals (those who are terminated or laid off between 9/1/08 and 12/31/09, and who aren't covered by another health plan) have a nine-month post-termination period when they have to pay only 35% of their COBRA premiums and the remaining 65% is reimbursed to the coverage provider (usually the employer) through a tax credit. If you earn more than \$125,000 a year, or \$250,000 jointly with a spouse, then you are subject to some recapture on this benefit, and eventually it phases out.

Second, ARRA provides a \$25 weekly supplement to the state Unemployment Compensation (UC) benefit each eligible individual receives. It also extends Emergency UC funding for claims filed by 12/20/09 (otherwise EUC would have expired in March 2009) and stipulates that all individuals who receive UC benefits can claim the first \$2,400 of those benefits tax-free for 2009 tax filing purposes.

Third, ARRA denies “golden parachutes” to executives who leave ailing firms participating in the bailout. No “golden parachutes” would be allowed for incoming executives for firms in the program. Outgoing executives who have severance packages more than three times their

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Fourth, ARRA addresses incentive compensation clawback provisions. Any bonus or incentive compensation to any senior executive officer based on “statements of earnings, gains or other criteria” has to be paid back if it is shown that the statements forming the basis of the payment were “materially inaccurate.”

Employer protections are always part and parcel of any contract? Anything new?

Bond: Employers are still very much interested in restrictive covenants: non-compete agreements, non-solicitation of clients, non-raiding of employees. Restrictive covenants are always governed by state law and the facts of each individual’s situation. Restrictive covenant law is entirely state law-driven, so you have to know which jurisdiction’s laws apply. The facts vary from person to person, and situation to situation.

Restrictive covenants have to be reasonable in terms of several factors. First is scope. In other words, you can’t tell executives they can’t work anywhere in the world if you only sell in the northeastern United States. Or anywhere in the automotive industry if all your company sells is automotive paint.

Second, the duration has to be reasonable; depending on state law, the industry and the type of work the employee did, this could be a year, maybe six months.

Third, there has to be good consideration, meaning something of value received by the employee from the employer in exchange for the restrictive covenant. If you give an employee an employment agreement that contains a non-compete, the employment agreement is generally considered good consideration to support the non-compete.

You don’t have to promise severance; just provide an employment agreement. Other ways to work in a restrictive covenant are by offering a severance agreement that contains a non-compete or putting that restrictive covenant in a stock option agreement. That’s fair, even if the options prove to be worth nothing over time.

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My advice to employers is to use a restrictive covenant only if the employee presents a true competitive threat, because if the courts find that there is really no legitimate business need for the protection, they won’t enforce it. And you will have spent significant money before you reach that judgment.

At some point down the road, hopefully sooner than later, the war for talent will heat up again. How can a company prepare for the future but still keep an eye on its current bottom line?

Bond: The short answer is to grow talent internally - and keep your top executives as happy and challenged as possible. Many executives have been badly burned by the current economy; now they would like to put down roots and make a commitment to a company with a future.

Employers need to communicate - through words and actions - that this is a good place to do interesting work, that there are growth opportunities and that the company will still be around in the future. Employees are very

aware of how tenuous the whole concept of job security has become in our country, and would very much like to be able to build something meaningful.

Any last thoughts?

Bond: Just a reiteration. Employers are definitely looking to get the biggest bang for their buck. Candidates are looking for security. They want to know that if they make a job move, there's some future for

them and, if there's not a future, there's some sort of protection.

In the end, creative approaches always win the day in terms of how deals can be structured to be fiscally responsible for all concerned and give the candidates the protections they're looking for. I urge all my clients to focus on what really matters to them - and to work that into a deal that benefits both sides of the equation.