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Negotiating the Terms of Executive Employment

Getting What You Deserve



If you are a software executive changing jobs, you could lose a lot of money or “crater” your career if you aren’t aware of opportunities in negotiating your new employment contract. If your skills and experience are what the company needs most, then you deserve—and can negotiate—terms commensurate with your value.

On the other hand, if you’re a corporate executive trying to recruit top talent, and your prized candidate says “show me the money” and you don’t have it, you need to know a smart way out of the box. It’s increasingly important to know how to use the employment contract as an attractive recruiting tool without giving away your company.

Negotiating Opportunities

While CEOs and other senior executives may be great negotiators when it comes to putting together acquisitions or partnerships, they often neglect negotiating the terms of executive employment.

The best time to negotiate these employment terms, including compensation, benefits, relocation, tax gross-ups, stock and options, is before an offer is made or accepted. There are 10 critical areas that executive candidates and software companies should consider negotiable. During negotiations, issues in these areas need to be raised, discussed, and resolved to assure that both parties are being treated fairly.

There are always two perspectives

in negotiations. Let’s consider the following 10-point checklist from both the negotiating executive’s point of view and also from what these candidates are apt to encounter in software company negotiations.

Top Ten Negotiable Terms

1. Signing bonus

Negotiating Executive: “The company should pay me something up front when I sign on. This bonus should at least make me whole for the vesting options, bonus, and other benefits I would lose in switching jobs.”

Corporate Reality: What a company pays up front can vary, depending on its need and the perceived immediate value. This bonus, earnest money or deposit paid, demonstrates a joint commitment and cements the legal and psychological bond between the potential executive employee and the company. Its purpose is to cover any known or foreseeable risks.

Signing bonuses have become more common in recent years. Today executive bonuses can include 15-25 percent of annual cash pay, 20-35 percent vesting of options, below-market stock, a retirement annuity, and other considerations. Creative negotiators will arrive at a signing bonus package that is attractive to the talent it wants, but within the company’s budget and financial structure, present or projected.

2. Meaningful Equity

Negotiating Executive: “The company should reward me for my

management and individual achievements with a real stock stake in the enterprise I help build.”

Corporate Reality: The company can structure stock or options comparable to industry standards. Equity recognition can be made even more valuable by the offer of a “full rights” package for the executive stakeholder, including anti-dilution, registration and cash-out protections, vesting and change of control protections, and extended exercise of options on employment termination. Usually, executives gain these protections in advance, but these packages can develop over time as executives prove their worth.

3. Tax-favored Equity

Negotiating Executive: “I want to leverage my future payout, so I want to structure equity to be taxed as low as possible and boost my take-home pay.”

Corporate Reality: Here, the rule of thumb is that options are the best way to go for high-value equity, and stock is more appropriate for low-value equity. But the best way for both the executive and the corporation, according to current federal tax laws, is to maximize the executive’s potential use of the 50 percent “deduction” for ordinary capital gains and, where possible, the 65 percent “deduction” for certain long-term gains in smaller software companies.

Tax advice needs to assure the right mix of equity for both the executive and the corporation. This mix can include: stock, incentive stock options qualified under the tax code (ISO), options not tax qualified (NQSO), stock appreciation rights (SAR), or Phantom Stock arrangements, each carefully structured to avoid ruinous “tax surprises” down the road. For example, tax on low-valued stock, at cash out, will be 14 percent using the lowest current capital gains rate. On the other hand, use of non-qualified options or failure to make appropriate

tax "elections" increases tax to 42 percent in the same situation. This executive's disaster is a bonanza for the company that deducts stock income. Here also the company should plan to make use of this windfall.

4. Relocation Assistance

Negotiating Executive: "I don't want to shoulder the cost of moving my family, but if the company moves me, neither do I want to pay more taxes on the relocation reimbursement, when I'm receiving no more real income."

Corporate Reality: Companies should expect to pick up the executive's tab for the cost of family and professional relocations, including quantifiable out-of-pocket cash expenses of temporary living, storage, moving, and perhaps dual mortgages and costs of home sale and purchase.

Companies can write contracts that avoid taxable income for the executive or that allow for tax gross-up, as needed. Increasing the length of temporary living arrangements can benefit both executives and companies by allowing each to try their relationship before making the larger commitments.

5. Position, Duties, Support

Negotiating Executive: "I want to know exactly what I will be responsible for and ensure I have the resources I need. Also, I want a position visible enough to keep me known in the industry."

Corporate Reality: It's in the interest of both parties to confirm officer and/or board positions, expected responsibilities, known performance targets, organizational authority, and reporting structures. These duties and targets can be adjusted later. To the extent understood, companies and executive candidates should also discuss staff, facilities, and budgets, and Director and Officer insurance. The company should also permit outside board and advisory positions that don't

present a conflict of interest.

6. Expense Payments

Negotiating Executive: "I expect the company to support me in cultivating my professional status and skills."

Corporate Reality: In addition to paying or reimbursing usual corporate perks and direct business generation activities, companies will often underwrite initiatives that keep executives current, visible and connected in their fields. These include not only trade organization memberships and subscriptions to publications, but also support for speaking and attending national meetings, trade shows, and continuing education programs.

7. Non-Compete and Non-Disclosure Agreements

Negotiating Executive: "I will agree to non-compete and non-disclosure agreements only to the extent that they involve current and future trade secrets and are based on specific parameters."

Corporate Reality: Companies must protect their existing and future trade secrets through non-disclosure agreements (NDA), but the NDAs should not reach into the candidate's prior knowledge or information generally known in the trade. Non-compete agreements should be separately calibrated for three concerns: the executive taking a job with a customer or direct competitor; soliciting customers or prospects; or raiding employees after having moved to another company. Whether the period is 12, 18 or 24 months, it should be measured by normal shelf-life of confidential information known and time needed for the company to re-establish itself and integrate a successor into the prior company's relationships.

8. Term/Termination

Negotiating Executive: "I want to know exactly what will happen if the company changes its mind about my value to it."

Corporate Reality: Companies should provide a fixed-term contract and mutual early termination clauses, with and without cause. That way candidates and companies enter relationships knowing the guidelines when and if a change in perceived value occurs in the future. With-cause termination clauses should be based on matters under the offending party's control. Without-cause termination should require each party to provide a notice period and to give up without-cause contract rights. Because without-cause termination allows either party to walk out of the agreement at any time of their sole choosing, they must give sufficient notice to allow the other to adjust and seek replacement. This can include loss of rights sufficient to discourage at-will termination.

9. Reasonable Severance

Negotiating Executive: "If termination occurs, I want a financial safety net severance package."

Corporate Reality: Severance is a candidate's protection against the company's normal right to terminate without cause while also holding an executive responsible for the non-compete clauses on termination. These vary by position. Six-months to one-year severance is most common, often phased on period of service with the corporation. This ballast, along with a requirement that any disputes be settled by less expensive binding arbitration, that attorney's fees be awarded to the prevailing party, and similar contract enforcement terms, gives both the executive and the company added confidence that the contract will be followed.

10. Good Vibrations

Negotiating Executive: "I want to work with people I like and respect, and who, in turn, respect me and value my contribution."

Corporate Reality: Personal com-

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patibility with the corporate culture and the company's need for the skills are key to the success of the executive/company partnership. In fact, the company's conduct in negotiating the terms of employment can offer valuable insight into its decision-making process, motivations, and flexibility. From this, candidates can estimate their potential fit.

All's Well That Blends Well

Both parties should never fear the word "no" in negotiations. It avoids creating a poor fit that would cause turmoil later down the road. However, creating a good contract does not—necessarily—ensure a good job choice. There is still no substitute for doing homework. Executives need to know

the company's present and future business prospects; companies need to check the background of executives they are pursuing. But, by thoughtfully negotiating in these "Top Ten" areas, each party will gather insights that will help them make better choices. The resulting employment contract should reflect the above-board style and approach of both parties and lay a foundation conducive to getting the best for all concerned. ■

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