

Do's and Don'ts of Employment Contracts

Presented to
Louisiana chapter
of the Association
of Corporate
Counsel

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*The information described in this program is general in nature, and may not apply to your specific situation. Legal advice should be sought before taking action based on the information discussed.

Housekeeping

Q&A

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Handouts

Following the webinar, a PDF copy of the materials can be provided via email.

First Question: *Is an employment agreement with a fixed term necessary?*

- Does the position justify a fixed-term agreement?
- Is it a deal breaker without?
- Will a term sheet or offer letter suffice?
- Is severance demanded by the individual?

Assuming a fixed term employment agreement is used

- Can you keep the term to one year with evergreen provisions?
- Are the cause provisions too employee-friendly?
 - Is a cure provision necessary and if so, is it reasonable?

Severance Considerations

- If the agreement is over one year, can you cap severance at one year or the duration of the agreement, whichever is less?
- Is severance conditioned upon the signing of a general release?
- Will severance be paid as a lump sum or over a period of time.
- Is severance conditioned on compliance with non-disparagement and/or restrictive covenant provisions?

Bonus Plan Considerations

- Is the bonus an incentive or discretionary bonus?
- Is it clear either in the EA or a separate plan when and how the bonus is earned and awarded?
- Remember, in Louisiana and other states, once the bonus period is over and targets are met, the bonus is vested, even if the employee is no longer employed when the bonus is paid.
- Note: There is language that could support bonus disqualification if the employee is no longer employed as of the bonus payout-date.
 - Employment in “good standing” as of the payout date.

Restrictive Covenants: Non-Disclosure Agreement

- NDA's should be used for every relevant hire – there is no down-side.
- Make sure the definition of confidential information is accurate.
- Make sure that you have language pursuant to the Fair Trade Practices Act
 - Employee may have certain rights under the Defend Trade Secrets Act of 2016, Pub. L. 114-153. An individual shall not be held criminally or civilly liable under any Federal or State trade secret law for the disclosure of a trade secret that: (A) is made (i) in confidence to a Federal, State, or local government official, either directly or indirectly, or to an attorney; and (ii) solely for the purpose of reporting or investigating a suspected violation of law; or (B) is made in a complaint or other document filed in a lawsuit or other proceeding, if such filing is made under seal. An individual who files a lawsuit for retaliation by an employer for reporting a suspected violation of law may disclose the trade secret to the attorney of the individual and use the trade secret information in the court proceeding, if the individual: (X) files any document containing the trade secret under seal; and (Y) does not disclose the trade secret, except pursuant to court order.

Restrictive Covenants: Non-Competes

- What is the applicable state?
- Is the non-compete language compliant with the applicable state?
- In Louisiana, for example, an employer must:
 1. List the parishes, counties or municipalities in which competition is prohibited;
 2. Describe the business in question; and
 3. Limit the non-compete to no more than two years.
- In Texas, it is where the employee did business and/or received confidential information.
- Is the restrictive covenant in relation to the sale of a business?

Restrictive Covenants: Non-Solicitation of Customers

- Is the non-solicitation of customers tied to a restricted territory?
- Does it conform with the applicable state law?

Restrictive Covenants: Non-Solicitation of Employees

- Generally, a restricted territory designation is not necessary, but check the applicable state.

Death and Disability Provisions

- Is the disability provision compliant with the Americans with Disabilities Act?
- A set time period noted for disability versus the individual's inability to perform the job with or without reasonable accommodation and with no definite return date?
- Is there leave of a definite duration and can it be reasonably accommodated?

Other Provisions in Employment Agreements

- Return of Company Property
- Injunctive Relief
- Severability
- Governing Law
- Inventions and Company Works
- Notices
- Successor and Assigns
- No Waiver
- Section 409(A)

Equity Award Considerations

- Is the employee receiving an equity-based award?
- Does the EA or a separate agreement or plan provide the terms of the award?
- Federal and state securities law issues
 - Public v. private company
 - Form S-8
 - Rule 701
- Tax considerations

Section 409A: Background

What is Section 409A?

- Enacted in 2004 under American Jobs Creation Act
- Intended to address abuses in the wake of Enron and WorldCom
- Very broad application

Section 409A: Background

Key Components of 409A

- The basic rules are deceptively straightforward
 - Code Section 409A is two pages
 - Final regulations are 400 pages – plus notices issued by the IRS providing additional guidance
- Three basic rules
 - Deferral election rules – regulate the timing of deferrals
 - Distribution rules – define permissible distribution forms and events
 - Modification and amendment rules – define circumstances under which changes are permissible

Section 409A: Background

Why Should You Care?

- Penalties assessed against employees are very harsh
- Employers have a reporting and withholding obligation
- Employers may feel a moral obligation to gross employees up for tax penalties or may be contractually obligated to gross-up

Section 409A: Background

- **Common Misconceptions**
- **Section 409A is applicable to:**
 - Service Providers
 - Employees, directors and independent contractors
 - Service Recipients
 - Taxable and tax-exempt entities
 - Tax-exempt entities are also subject to Section 457, so 409A typically only affects severance payable to their employees

Section 409A: Background

How is nonqualified deferred compensation (NQDC) defined?

- Basic definition: any compensation in exchange for services that *is earned in one taxable year and paid in a later taxable year*
- Must determine the period over which the compensation is earned and when the employee obtains a legally binding right to the compensation
- 409A applies to many items not typically thought of as NQDC, but some may be excluded from 409A by an exception

Section 409A: Background

NQDC does not include:

- “Qualified’ deferred compensation – e.g., 401(k) and 403(b) plans
- “Bona fide” vacation, sick leave, compensatory time and death benefits
- Nontaxable benefits – e.g., certain educational benefits, indemnification
- Payroll year-end straddle period
- Certain annualized compensation arrangements – e.g., teacher salary

Section 409A: Background

Common exceptions to 409A

- Grandfathered amounts
 - Amounts must be earned and vested before January 1, 2005 and not materially modified
- Stock rights exception
 - Stock options with exercise price => FMV at time of grant
 - Restricted stock subject to Section 83
- Short-term deferral exception
- Involuntary separation pay exception

Section 409A: Background

Short-term deferral exception:

- Generally, the NQDC must be payable no later than March 15th of the calendar year following the calendar year in which the payment is no longer subject to a 409A “substantial risk of forfeiture”
- Exception not available if payment could be made later than deadline
- Limited permissible late payments without losing exception
 - Legally required delay
 - Payment would jeopardize employer’s ability to continue as a going concern

Section 409A: Background

Involuntary separation pay exception:

- 409A “separation from service”
- Only payable in the event of an involuntary separation from service
 - “Good Reason” provisions okay if substantially equivalent to an involuntary termination
- Up to 2x lesser of:
 - Employee’s 409A “annualized compensation”
 - Code Section 401(a)(17) limit - \$285,000 for 2020

Section 409A: Background

Permissible Payment Events

- If no exception applies, amounts that are subject to 409A may **only** be distributed on a “permissible payment event”:
 - On a specified date or pursuant to a specified schedule (not a specific event)
 - **Separation from service**
 - Change in control (as defined in 409A)
 - Occurrence of unforeseeable emergency (as defined in 409A)
 - Disability (as defined in 409A)
 - Death

Section 409A: Background

What is a 409A “separation from service”?

- Does separation from service = termination of employment?
- Presumption of separation
 - If services permanently decrease to 20% or less of average services performed over immediately preceding 36-month period, presumed to be a separation
 - If 50% or more, presumed to be no separation
- In between 20%-50% - no presumption
- “Plan” may adopt its own rule by setting a level of services – greater than 20% but less than 50% of the average level of services provided over preceding 36 months – that will trigger a separation from service

Section 409A: Employment Agreements

Employment agreement terms that may implicate 409A:

Severance pay	Change in control benefits
Annual Bonuses	Outplacement services
Long-term bonuses	Offsets
Equity Awards	409A catch-all provision
Reimbursements	

Section 409A: Employment Agreements

Red flags to watch out for:

- Conflict between (i) the payment terms in employment agreement, and (ii) the payment terms under the applicable compensation arrangement
- Payment substitution provisions
- Use of “as soon as possible” for payment
- Giving the employee or the employer the discretion to accelerate payment of NQDC without including the subsequent election requirements
- Toggle issues
- Inconsistent 409A provision

Questions?



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