



888 17th St. NW, Ste. 1100  
Washington, DC 20006  
Tel: 202.857.1000  
Fax: 202.857.0200  
[www.pilieromazza.com](http://www.pilieromazza.com)

# Managing and Incentivizing Employees: Sharing in the Upside While Protecting the Company's Downside

A WIPP Give Me Five Webinar  
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# Presented By

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Dean Nordlinger, Partner  
 Business and Corporate Law Group  
[dnordlinger@pilieromazza.com](mailto:dnordlinger@pilieromazza.com)  
 (202) 857-1000



Nichole Atallah, Associate  
 Labor and Employment Law Group  
[natallah@pilieromazza.com](mailto:natallah@pilieromazza.com)  
 (202) 857-1000



# In these days of Uncertainty...

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Current economic, political and regulatory environment pressures to name a few...

- Future uncertainty (elections, Congressional infighting)
- Government spending trends
- New compliance rules and regulations

A company's success turns on the ability to attract, retain, reward and motivate the right people (especially due to these pressures)

# Webinar Scope

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Can the company afford to **not** do this?

- *Sharing in the Upside:*
  - Equity sharing incentives
  - Incentives without giving up ownership and control
  - Getting the most out of your plan through proper communication
  - The employee handbook - expectations and clarity
- *Protecting the Downside:*
  - Employment agreements, the right way to protect your asset
  - Non-compete agreements
  - Appropriate vesting and forecasting of incentive plans



# Determining the appropriate "starting point"



# Determining the appropriate “starting point”



- Not a one size fits all!
- Relevant and useful no matter the stage of a company's life cycle
- Evaluate company culture, talent pool and current employee retention and motivation programs
- Alignment of the following:
  - Company and shareholder goals
  - Employee capabilities and commitment
  - Tasks and objectives, and confidence it can be done



# Fundamental Questions regarding Sharing in the Upside

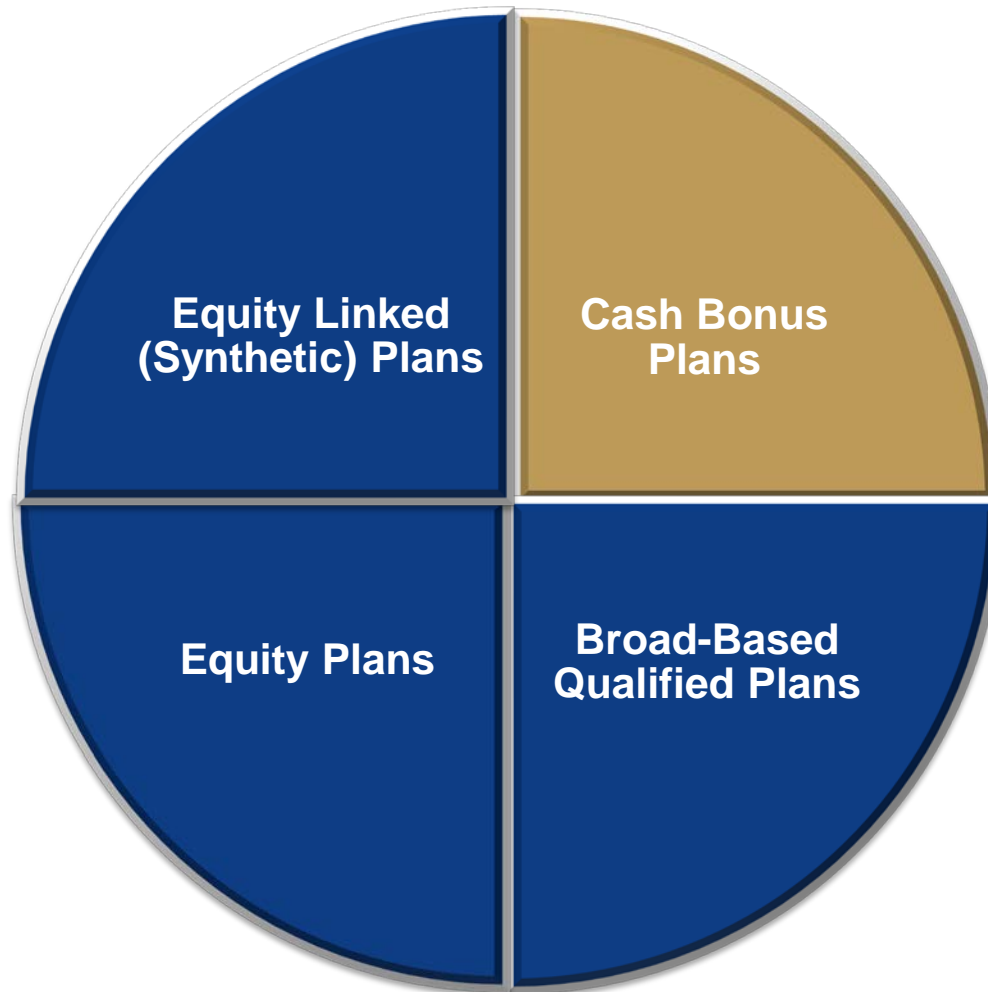
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- Does the company want to share real equity?
- How much of the company's equity or equity value is to be shared?
- Will awards be paid in stock or cash?
- Which employees will be eligible to participate (executive officers versus "rank and file")
- Will employees have to make a monetary contribution to get the equity value?
- How and when will liquidity events occur?
- How is the award earned and can the company take it away?



# Universe of Incentive Plans for today's discussion





# Purpose of Incentive Plans – Recruit, Retain and Motivate Employees



- All forms of incentive plans are helpful in recruiting employees
- Some incentive plans are more retention-oriented (e.g., RSUs or phantom stock)
  - “full elevator ride” in value
- Other incentive plans are more motivation-oriented (e.g., SARs plan)
  - solely increase above floor value



# Cash Bonus Plans

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- Key metrics – profitability, DSO, revenue, etc.
- Transactional – at “change of control”
- Retention bonus – typical in “merger and acquisitions”
- Discretionary
- Spot bonus – special on the “spot” recognition
- Sign on bonus
- Commission plans
- Holiday bonus
- And more ...

# Broad-Based Qualified Plans

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- Building an ownership culture throughout the company (not just key employees) using:
  - Employee Stock Ownership Plan (ESOP)
  - Employee Stock Purchase Plan
  - Retirement Plans (401k)
  - Stock Option Plan

# Equity Plans

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- Sharing in “real” equity through :
  - Stock option plan
  - Profits interest
  - Restricted stock plan
  - Employee stock purchase plans
  - Restricted stock units (settled in stock)
  - SARs plan (settled in stock)

# Synthetic equity (equity linked)

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- Incentives without giving real equity, but tying performance to equity
  - Restricted stock units (settled in cash)
  - SARs plan (settled in cash)
  - Phantom stock plan (settled in cash)



# What Makes An Effective Incentive Plan?



- Keep it simple
- For the company
  - Ease of implementation, award and tracking
- For the recipient
  - Employee understands how the plan works
- For the company compliance team
  - Ease of executive team and professional advisors monitoring ability
- Create an Ownership Culture
  - ownership combined with employee involvement in business and operations decisions (e.g., employee task forces) to foster employee meaning and connection to plan



# Certain Considerations in Choosing an Equity Linked or Equity Incentive Plan



## Compliance

- Legal
- Financial and accounting
- Federal and state income taxation
- Allowability under Federal Acquisition Regulations and indirect rate impact
- Regulatory impacts (e.g. 8(a), SDVOSB, or WOSB)
- Valuation requirement
- Entity restrictions
- Securities laws

## Control Impacts

- Does the company want to give real equity?
- Voting rights and how many owners?
- How much equity to give up and what is the value of the equity today and potentially in the future?



# Plan Set-Up and Monitoring of Equity Linked and Equity Incentive Plans Common Characteristics



- Establishing a pool – how much equity or equity value is to be shared
- Projecting impact – financial modeling to determine what is best
- Liquidity and timing of payments – what are the triggering events for payment (e.g., sale of the company)
- Vesting – time-based, performance-based or both
- Forfeiture – acts or events by which eligible employee could forfeit awards
- Company changes – things that affect the value of equity linked or equity awards: need to account for these things in drafting of incentive plan documents
  - Results – appreciation or depreciation
  - Turnover and forfeitures
  - Changes in company capitalization (e.g., stock split)





# Equity Linked Incentive Plans

## Common Characteristics

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- Not real equity (no path to ownership)
  - No triggering of “fiduciary duties” to minority owners
  - No ownership rights – e.g., voting and financial/information
- To increase retention and/or increase company/equity value
- Typically, no capital investment requirement
- Benefit typically tied to specific date/event in the future
- Monetizing event taxed at ordinary income tax rates
- Typically, do not trigger compliance with securities laws (if awards in cash only)



# Equity Incentive Plans Common Characteristics



- Real equity (path to ownership)
  - Triggers fiduciary duties to minority owners
  - Ownership rights – e.g., voting and financial/information
- To increase retention and/or increase company/equity value
- Typically, subject to vesting schedule and forfeiture
- Typically, some capital investment requirement
- Benefit typically not tied to specific date/event in the future
- Monetizing event often taxed at capital gains tax rates
- Securities laws compliance



# Employment Agreements- Why Now?

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- Capturing incentives
- Mutual understanding
- Consistency
- Give & take



# Structure and Balance

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## Employer interests in:

- Retention
- Termination with minimal adverse impact financially and legally
- Post-employment protection

## Employee interests in:

- Compensation
- Employment security
- Rights and flexibility post-employment termination

# What Type of Employment Agreement?

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## Initial Considerations...

- Level of employee(s)
  - Executive Officers versus Rank and File
- Type of industry
- Exposure to sensitive information like trade secrets, client contacts, etc.
- Form of the agreement
  - Simple letter or formal agreement



# What's Inside?

## The Meat and Potatoes

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1. Scope of Employment
2. Salary
3. Bonus Structure
4. Benefits
5. Term and Termination – “at will” v. “term”
6. Liability Protection
7. Other Incentive Plans
8. Confidentiality
9. Invention Assignment
10. Restrictive Covenants
11. Breach
12. Dispute Resolution
13. Change of Control



# Key Legal Issues with Executive Agreements



- Structuring the **term of employment** (job description and incentives)
- Determination of **competitive compensation agreements**
- Consequences of **change of control**
- **Intellectual property** protection
- Structuring **exit arrangements** (basis of termination, economic consequences, dispute resolution)



# Employment Term

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## “At Will”

- No term
- Grounds for termination can be for any legitimate, non-discriminatory reason
- No cause compensation?

## Term

- A definite term
- How long is too long?
- Ground for termination dictated by the agreement.
- Bonus plans, other incentives



# Structuring Termination: Employer

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## For Cause

- Define “cause”
- Notice and opportunity to cure
- Forfeiture of bonus, incentives, severance, equity interests

## No Cause

- Anticipate “left-overs” not captured in defining cause
- Notice
- Severance, accelerated vesting, performance bonus, health benefits, outplacement services, relocation . . .



# Structuring Termination: Employee **PM**

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## “For Good Reason”

- Defined
  - Employee quits but exit is treated as termination without cause
- Notice and Cure



# The Complex World of Restrictions **PM**

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- Confidentiality
- Non-Disparagement
- Non-Competition
- Non-Solicitation
- Invention Protection and Assignment



# Pitfalls in Drafting Restrictions

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- Language matters
  - say the “magic words”
  - creating flexibility on both sides
- Jurisdiction is key
- When a potential violation occurs
  - anticipating your tool kit



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Dean Nordlinger

[DNordlinger@pilieromazza.com](mailto:DNordlinger@pilieromazza.com)

202.857.1000

Nichole Devries

[NDeVries@pilieromazza.com](mailto:NDeVries@pilieromazza.com)

202.857.1000





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