



888 17th St. NW, Ste. 1100
Washington, DC 20006
Tel: 202.857.1000
Fax: 202.857.0200
www.pilieromazza.com

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

A PiliroMazza Breakfast Seminar
with Aronson LLC
September 13, 2012

Aronson LLC
805 King Farm Blvd.
Suite 300
Rockville, MD 20850
Tel: 301.231.6200
Fax: 301.231.7630
www.aronsonllc.com





Presented by:

Dean Nordlinger, Partner
with PilieroMazza's Business and Corporate Law Group

Nichole DeVries, Associate
with PilieroMazza's Employment Law & Litigation Groups

Jim Fennel, CPA, Partner
with Aronson's Government Contract Services Group



In these days of Uncertainty...

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

- Sequestration and future uncertainty
- Project delays
- Government spending trends
- New compliance rules and regulations
- Income tax rates

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

Seminar Scope

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”



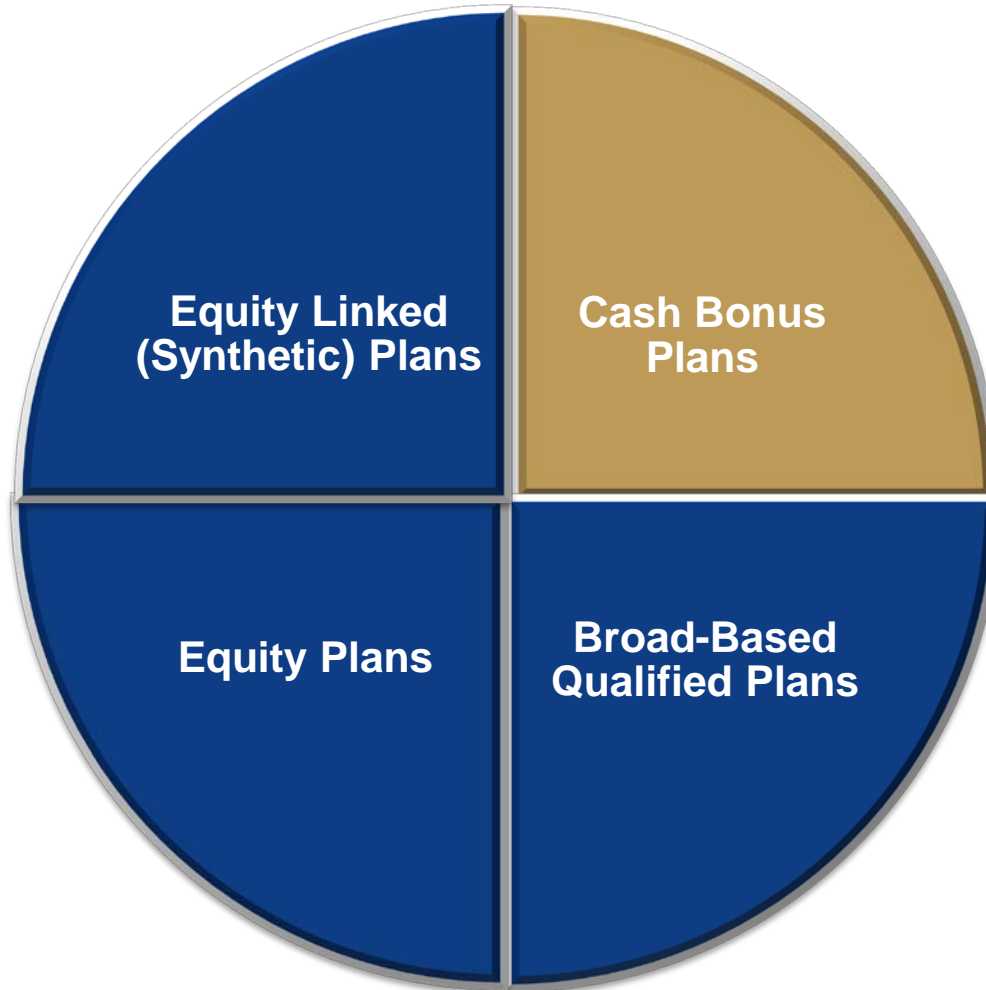
Determining the appropriate “starting point”

- 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

- 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

- 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

- Building and 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

- 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)

- 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

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

- 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

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

Structure and Balance

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

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

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

- 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)

“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

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 . . .

“For Good Reason”

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

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

Pitfalls in Drafting Restrictions

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



888 17th St. NW, Ste. 1100
Washington, DC 20006
Tel: 202.857.1000
Fax: 202.857.0200
www.pilieromazza.com

Managing and Incentivizing Employees

Dean Nordlinger
DNordlinger@pilieromazza.com

Nichole Devries
NDeVries@pilieromazza.com

Jim Fennel
JFennel@aronsonllc.com

Aronson LLC
805 King Farm Blvd
Suite 300
Rockville, MD 20850
Tel: 301.231.6200
Fax: 301.231.7630
www.aronsonllc.com

