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STRATEGIES FOR NEGOTIATING EXECUTIVE SEPARATION AGREEMENTS FOR EXECUTIVES

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Employers believe that terminated executives stand at a significant disadvantage in negotiating separation agreements. For this reason, they often refuse to negotiate at all. They refuse any changes to their standard agreements and impose strict deadlines for execution and return of the separation agreements. The severance offered in exchange for the agreement is usually only enough to make it difficult to turn down.

If this were the entire story, executives would never succeed in negotiating better separation agreements and richer severance packages than employers offer. Yet they do. This practice note offers advice on how to negotiate separation agreements for executives, using bargaining power and leverage that many executives do not even know they have.

How Employers View Negotiations

Employers commonly assume that terminated executives have no bargaining power and once the employment relationship ends, they owe them nothing. If an employer wants a general release of all claims from an executive, however, the employer knows it must offer something more than the executive would otherwise be entitled to receive. But an employer will often seek to limit such consideration to the least amount required to obtain the executive's agreement, rather than provide what is fair.

Even an employer who recognizes an executive's past contributions may act stingily. The employer believes it has already paid for these contributions. An employer that is a public company also believes that providing more than the minimum necessary to obtain a general release from a terminated executive will bring undesired investor scrutiny.

Employers also commonly assume that terminated executives are so needy that they will sign any separation agreement put in front of them. They believe that the act of termination alone leaves the executives feeling helpless. In fact, employers count on this occurring.

Why Employers Negotiate

For a variety of reasons – despite their position of power and general reluctance to provide a generous severance package – many employers will nevertheless negotiate.

Litigation Risk

Given the many laws that affect the workplace today, hardly any employer can confidently state that they comply fully with every law. The potential for audit, investigation, and litigation and a concomitant finding of liability is, therefore, always present. For employers who value their public images, which can easily be tarnished, negative publicity about a claim or lawsuit or even the threat of one can provide bargaining power to executives.

That said, the majority of employers know a viable claim from one without merit and will not pay more than nuisance value for a meritless claim. These employers also know that most executives are reluctant to devote time and expense or expose themselves to

reputation risk unless the claim is likely to succeed and obtain a substantial recovery.

Still, for executives who have viable claims, rattling the employer with the threat of a lawsuit or actually filing one can be very persuasive.

Acknowledged Risks

Even when executives do not have viable claims or they decide not to bring or threaten viable claims, they still have bargaining power. This bargaining power derives from the business risks that employers face when terminating employees, including the possibility that executives may:

(1) Misappropriate and disclose confidential information;

(2) Compete with the employer after termination;

(3) Solicit customers, potential customers, and continuing employees;

(4) Interfere with relationships with suppliers, vendors, and others on whom the employer relies; and/or

(5) Disparage and make derogatory statements about the employer and its executives.

Employers attempt to protect against these business risks with restrictive covenants. But employers cannot guarantee compliance, and enforcement by the courts is unpredictable.

Reputation Risk

Employers also fear reputational risk arising out of employment terminations. This includes the loss of others' good opinion and esteem. A separation agreement and general release, no matter how tightly drawn, cannot protect fully against this risk.

For example, although a non-disparagement agreement can protect against public bad-mouthing of an employer and its senior executives, disparagement is difficult to prove and enforcement can bring to light additional facts that an employer might want hidden. For guidance on drafting non-disparagement clauses, please *see the "Non-Disparagement" section of Understanding, Drafting, and Negotiating Separation Agreements — Understanding and Negotiating Common Provisions in Separation Agreements*. Moreover, no court injunction can undo what was said, and money damages may be a poor substitute for a lost customer. True stories an executive may tell about mistreatment may also make it harder for an employer to recruit new executives and harder to maintain the morale of those executives who remain.

Relationship Risk

Related to reputation risk, relationship risk pertains to how a customer, a prospective customer, a vendor, or supplier views its relationship with the employer. Although restrictive covenants can mitigate this type of risk, they cannot completely negate it.

Non-compete and non-solicit of customer agreements can offer legal protection against an executive's efforts to take market share from an employer or steal the employer's customers. For guidance on drafting restrictive covenants, please see *Understanding, Negotiating, and Drafting Non-Competes; Understanding, Negotiating, and Drafting Customer Non-Solicitation Agreements; and Understanding, Negotiating, and Drafting Employee Non-Solicitation Agreements*. Non-solicit of employee agreements can offer protection against poaching or encouraging other employees to leave. But these restrictions cannot compel a terminated executive to speak well or even neutrally about a former employer. And, they cannot compel a terminated executive to reassure customers of the capability, competence, and judgment of their successors in meeting the customers' needs.

A terminated executive can damage an employer's relationships as much by what he or she does not say as what the executive does say. When circumstances suggest that a terminated executive should say more, their remaining silent, saying "no comment," or offering only faint praise greatly increases relationship risk. An especially dangerous situation arises in the case of

terminations of well-liked executives who have developed long standing or personal relationships with the customers. These customers will be especially attuned to what an executive says – or does not say.

Revelation Risk

Revelation risk is what terminated executives may reveal about an employer. During employment, executives learn things that could lead to scrutiny by outsiders. Confidentiality and non-disclosure covenants can protect against the use or misappropriation of confidential information, but not everything that is learned by an executive qualifies as confidential information under the law. For more guidance on drafting confidentiality agreements, please see *Understanding, Negotiating, and Drafting Non-Disclosure Agreements*. Executives usually respect business norms and standards and do not reveal this information after employment ends. But when they believe their employers have treated them unfairly, they feel less constrained.

Rejection Risk

Rejection risk is the failure of the employer's negotiator to convince the executive to sign and return the separation agreement. Rejection risk arises when an employer's negotiator shows no empathy for a terminated executive, does not take the executive's interests into account, and makes no real concessions or limits concessions to incidentals. Unless an employer's negotiator fully understands the dynamics of the negotiations and correctly concludes that the terminated executive cannot harm the employer, he or she may miscalculate and waste the opportunity to reach an agreement.

A Step-by-Step Negotiating Strategy

Step 1: Coach from the Sidelines

Unless the lines of battle have already been drawn, it is often best, at least at the outset, to have the executive speak directly with the employer about what the employer will offer upon separation. You should shadow the exchange and provide guidance from the sidelines. In preparing the executive, you should consider and evaluate the pros and cons of alternative strategies and tactics. You should also write talking points for the executive.

Having the executive start the negotiation is usually less confrontational than having you, as counsel, surface immediately. Also, this approach will less likely result in the employer's counsel becoming involved. If involved, the employer's counsel may focus more on the executive's lack of legal rights rather than other factors that favor the executive's interests. Having the executive engage first may also lead to the employer revealing how it feels about the executive and the reasons why it does not feel obligated to offer a greater severance package.

Step 2: Reframe the Negotiation

Employers will attempt to control the entire process. They generally assume they alone will decide what rules will apply. This includes what they are willing to discuss, with whom, how long the discussions will go on, and when they will end. Whether through your client or on your own, you must make it clear that the employer's view of negotiations – issues, interests, options, and standards – is not the only perspective and, in any event, your client does not accept the employer's view as the basis for resolving the issues your client wants to raise. Two examples are:

- An employer says that its severance plan benefit, based on years of service, is two weeks of salary times years of service, capped at twenty years. You represent an executive with more than twenty years of service who does not accept this as fair or just. You reframe the issue, interests, and standards to include your client's as well as the employer's. Once reframed, you show how neither party can fulfill its interests if the employer insists upon its capped benefit. Your counter proposal

includes options and alternatives that maximize the benefit's value to the executive.

- An executive has received annual bonuses and awards of restricted stock, stock options, and stock appreciation rights, or phantom equity, such as restricted stock units. The executive has been terminated without cause due an elimination of position. The employer refuses to provide a pro-rata bonus for the termination year or accelerate vesting of any awards or extend the exercise date of any vested options. You reframe the issue, interests, and standards to include your client's as well as the employer's. Even if the company's plans provide for forfeiture on termination of unvested bonuses or awards, the cash value of these bonuses and awards can be calculated or estimated and, in whole or part, paid in some other form as part of a severance arrangement. The exercise periods of stock options can also be extended so the executive is not forced to exercise when the employer's stock price is volatile.

Step 3: Consider Alternative Solutions

If you are creative, there are many alternatives you may introduce to increase a severance benefit, for example:

- Postpone the executive's termination date to provide a longer period for salary, bonus and benefits to continue and equity, quasi-equity, or other deferred compensation to vest – even if it means placing the executive on a terminal leave of absence;
- Bridge service to increase a retirement or profit-sharing plan benefit;
- Add a consulting period;
- Exchange fixed or variable duration severance;
- Have more money allocated as consideration for non-compete covenants or other commitments by the executive to the employer, especially if this helps with the optics of the agreement;
- Add more fringe benefits during the severance pay period; and
- Re-label a benefit amount, call it something else, or give the executive the dollar equivalent in some other form to use to offset other expenses.

Step 4: Find the Employer's Most Vulnerable Points

In negotiating with an employer, you must press on whichever types of risks, as listed above, you perceive present the greatest vulnerability to the employer. Decide what you can legitimately use as a lever and who, when, and how to use the lever to bring pressure to bear.

Virtues and Values

Virtues and values are levers. Most employers want to be held in high esteem and be respected for their fairness to terminated executives. Also, employer negotiators, as individuals, want to be respected for their decency and honor.

Your appeal to virtues and values works best if the employer's negotiator is willing to acknowledge that the severance package offered is inadequate to provide sufficient funds to allow the executive to meet fixed and anticipated costs and expenses until the executive can find another job and/or the separation agreement with post-employment restrictions will impede the executive's ability to earn a livelihood. But appealing to virtues and values has its limits, and making an employer or its negotiator aware of the logic and rationale of your demands may not suffice to motivate the employer to change its offer.

When using virtues and values as a lever, an executive should not feel restricted in whom he or she can speak with at the employer about the inequity of its offer. The executive should identify for you the persons at the employer with the position, authority, and inclination to provide help.

Emotional Ties and Connections

Emotional ties and connections are levers. You appeal to emotional ties and connections by triggering the guilt of a senior executive who recruited your client from a

secure position elsewhere; the feeling of indebtedness of a senior executive who benefitted from your client's hard work; the shame of a senior executive who inwardly knows that his or her failings or mistakes possibly contributed to your client's termination; the embarrassment of a senior executive who did not give your client sufficient notice or warning of the termination to come; or the humiliation of a senior executive who could not prevent your client's termination. It may also mean appealing to friendship and support from another higher level executive or a Board member who can influence the negotiations or who the employer's negotiator reports to or respects.

Fears and Anxieties

Fears and anxieties are very effective levers. Employers fear most losing what they believe they need and must have and, to an even greater extent, what they already have. If you can convince an employer that your client can take away, by action or inaction, what the employer must have, the employer will respond. If the employer cannot prevent this from happening on its own, you have powerful leverage. How far you have to go to show your client's resolve and commitment to follow through will depend on the circumstances. But once the potential loss is understood, few employers will want to risk the consequence that this will occur or reveal their lack of control over the outcome.