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# **Best Practices for Terminating Executives**

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## Prior to Termination

- **Gather and Review All Relevant Documents Governing Executive's Employment and Benefits**
  - Entire written employment agreement(s), if any (with any attachments)
  - Restrictive covenant agreements
  - Restricted stock awards, option agreements, or other agreements regarding securities or equity owned by executive
  - Applicable benefits policies/plans





## Prior to Termination

- **Identify Any Procedural Prerequisites for Termination**
  - Determining if termination must be “for cause” or “for good reason,” or for other grounds stated in an employment agreement, understanding the differences and assessing what proof will be necessary if termination is challenged
  - Conducting an investigation (if appropriate)
  - Providing notice and an opportunity to cure
  - Securing Board of Directors’ approval if necessary
  - Conducting a termination risk analysis (e.g. consider if employee may have potential viable claim under employment discrimination laws, etc...)



## Prior to Termination

- **Determine the Amount and Timing of Any Compensation to Be Paid Upon Termination**
  - Severance?
  - Bonus/commissions?
  - Continued or replacement benefits?
  - Can compensation be conditioned on the execution of a release? If so, work with counsel to ensure that an appropriate release is prepared.



## Prior to Termination

- **Determine Whether the Termination Will Trigger Any Consequences for the Equity Ownership of the Executive**
  - Will options be forfeited or, alternatively, will they vest at an accelerated rate?
  - Does the company have an obligation or a right to repurchase the executive's shares? If so, when must the right be exercised?
  - If the company does not have the right to repurchase any equity held, what other options are available, if any, to part ways?
  - Is a valuation necessary and, if so, using what criteria?



## Prior to Termination

- **Ensure that the Business is Ready for the Executive's Termination**
  - Do key customers/relationships need to be transitioned?
  - Is there a successor or a succession plan in place?
  - Does the executive have unique knowledge that needs to be accessed?
  - Does the company need to engage a public relations firm to assist with messaging the termination?
  - Is a transition agreement needed?



## Prior to Termination

- **Prepare for Potential Competition by the Executive**
  - Are restrictive covenants in place (in an employment agreement, separate restrictive covenant, benefits plans, restricted stock agreements, etc...)?
  - If so, are the covenants enforceable? To what extent?
  - If not or if uncertain, consider incorporating new covenants into a separation agreement. Involve counsel with this analysis.
  - Are trade secrets/confidential information/intellectual property adequately protected?
  - Will other valued employees likely leave with the terminated executive?



## At the Time of Termination



- Convey the decision appropriately under the circumstances (and with a prepared script, if you anticipate a difficult event) recognizing that claims can arise from an executive employee's anger at the manner of termination.
- Present appropriate paperwork (including a separate agreement, if any). Involve counsel as needed particularly if you are trying to “cut a deal” at the same time that you are communicating the termination decision.





## At the Time of Termination

- **Ensure that Company Property/Technology is Properly Secured**
  - Collect cell phone, computer, keys, credit cards, car, sales materials, etc...
  - Cut-off access to company computer system
  - Delete or gather all company information from employee's home or personal computer
  - Transfer e-mail account and voicemail



## At the Time of Termination

- **Handle Associated Marketing and Operational Issues**
  - Remove executive from the company website
  - Communicate the departure internally and externally (again, using a public relations professional, if appropriate)
  - Arrange for employee's resignation or termination as a member of the Board, office of the company and/or its affiliates, etc...



## After the Termination

- Ensure that post-termination compensation is paid timely and strictly according to agreement.
- Note that some states have strict payment upon termination requirements, e.g. Texas Payday Law which requires payment of all compensation owed to an employee who is discharged from employment not later than the 6<sup>th</sup> day after the date the employee is discharged.
- Monitor for competition, and act decisively if you become aware that former executive is engaging in unlawful behavior or any conduct in breach of separation agreement.



# Preparing to Fire an Executive

## Step 1: Root Cause Analysis

- While it is possible to fire an executive for bad behavior, incompetence or laziness, those cases are rare and relatively easy.
- Unfortunately, unless you have a horrible hiring process, those are probably not the reasons why you got to this point.
- The wrong way to view an executive firing is as an executive failure; the correct way to view an executive firing is as an interview/integration process system failure.\*
- \* See Forbes, *Preparing to Fire An Executive*, by Bruce Upbin, <https://www.forbes.com/sites/bruceupbin/2011/08/23/preparing-to-fire-an-executive#9d51953119e4>



# Preparing to Fire an Executive

## Step 1: Root Cause Analysis (cont'd)

- The first step to properly firing an executive is figuring out why you hired the wrong person for your company
  - You did a poor job defining the position in the first place
  - You hired for lack of weakness rather than strength
  - You hired for scale too soon
  - You hired for the generic position
  - The executive had the wrong kind of ambition
  - You failed to integrate the executive



# Preparing to Fire an Executive

## Step 2: Informing the Board

Board  
of  
Directors



- Informing the board is tricky and many issues can complicate the task:
  - This is the 5<sup>th</sup> or 6<sup>th</sup> executive you had to fire
  - This is the 3<sup>rd</sup> executive that you fired in this role
  - The candidate was referred by a board member who recommended the executive as a superstar
- In any of these cases, the board will be at least somewhat alarmed and there is nothing you can do about that.



# Preparing to Fire an Executive

## Step 2: Informing the Board (cont'd)

- BUT keep in mind your choices are:
  - (a) Alarm the board; or
  - (b) Enable an ineffective executive to remain in her position.
- While choice (a) is not great, it is better than choice (b).
- Leaving a failing leader in place will cause an entire department in your company to rot.
- Let that happen and the board will be more than alarmed.

Board  
of  
Directors





# Preparing to Fire an Executive

## Step 2: Informing the Board (cont'd)

Board  
of  
Directors



- You should have three goals with the board:
  - Get their support and understanding for the difficult task that you will execute
  - Get their input and approval for the separation package
  - Preserve the reputation of the fired executive
- This news is usually handled better with phone calls than in dramatic fashion during a board meeting.
- Individual calls will be particularly important if one of the board members introduced the executive to the company.





# Preparing to Fire an Executive

## Step 3: Preparing for the Conversation

- After you know what went wrong and have informed the board, you should tell the executive as soon as possible.
- The executive will remember the conversation for a very long time, so you need to get it right.
- Three keys to getting it right are:
  - Be clear on the reasons
  - Use decisive language
  - Have the severance package approved and ready



# Preparing to Fire an Executive

## Step 4: Preparing the Company Communication

- After you have informed the executive, you must quickly update the company on the change. The correct order for informing the company is:
  1. The executive's direct reports – because they will be most impacted;
  2. The other members of your staff – because they will need to answer questions about it; and
  3. The rest of the company.
- All of these communications should ideally happen on the same day and preferably within a couple of hours.



## Preparing to Fire an Executive

### Step 4: Preparing the Company Communication (cont'd)

- When you update the company, you might worry about employees misinterpreting the news and thinking the company is in trouble.
- Do not try to engineer around such a reaction.
- When you expect your employees to act like adults, they generally do.
- If you treat them like children, then get ready for your company to turn into one big Barney episode!



# Recognizing Potential for Unemployment Claim

## Texas Unemployment Compensation Act:

- An individual is disqualified for unemployment benefits if the individual was discharged for “**misconduct connected with the individual’s last work.**”
- “Misconduct” means mismanagement of a position of employment by action or inaction, neglect that places in jeopardy the lives or property of others, intentional wrongdoing or malfeasance, intentional violation of a law, or violation of a policy or rule adopted to ensure orderly work and the safety of employees...
- Right to file claim for unemployment benefits in Texas cannot be waived, and a release of such claims is not valid.



## Responding to Potential Unemployment Claim

### Texas Unemployment Compensation Act –

- **Misconduct Connected with the Work (cont'd):**
- Texas Workforce Commission – Initial Determinations & Appeal Tribunal Telephone Hearings
  - Why Did You Fire The Employee?
  - Was There a Final Incident That Led to the Firing?
  - Did You Give the Employee Prior Warning?
  - Was Employee Subject to A Progressive Disciplinary Policy/System?



## Responding to Potential Unemployment Claim

- **Collateral Estoppel Doctrine Inapplicable To TWC Findings:**
  - A finding of fact, conclusion of law, judgment or final order made by the Texas Workforce Commission on an unemployment claim is not binding and may not be used as evidence in an action or proceeding, other than an action or proceeding brought under the TX Unemployment Compensation Act, even if the action or proceeding is between the same or related parties or involves the same facts. (Texas Labor Code Section 213.007)
  - TWC Appeal Tribunal telephone hearing is recorded and is discoverable under Texas Open Records Act.
  - Sworn testimony at hearing may still be admissible in a subsequent proceeding.



# Recognizing Potential For Texas Payday Law Claim

- **Texas Payday Law:**
- In 1989, the Texas Legislature amended the Texas Payday Law to create an administrative procedure for a claimant to file a wage claim with the Texas Workforce Commission (TWC).
- **Wages** are defined broadly as:
- “Compensation owed by an employer for labor or services rendered by an employee.... and vacation pay, holiday pay, sick leave pay, parental leave pay, or severance pay owed to an employee under a written agreement with the employer or under a written policy of the employer.”
- Employee who is discharged must be paid “all compensation owed” no later than 6<sup>th</sup> day after date of discharge.



## Key Considerations For Severance Agreements

- **At a Minimum, Severance Agreement Should Include The Following Key Terms:**
- Time for payment of consideration
- Acknowledgment of sufficiency of consideration and that it is additional compensation that company is not otherwise required to pay
- Description of gross severance payment less normal and required withholdings and that it represents the equivalent of the employee's full salary for x time period (number of weeks or months, etc..)
- Acknowledgment that employee is receiving all compensation earned, including any unused vacation earned through date of separation of employment, regardless of whether employee executes the severance agreement.





## Key Considerations For Severance Agreements

- **Additional Key Terms (cont'd):**
- Acknowledgement that executive will cease to be eligible to participate in company's benefit plans, including health, dental and life insurance, bonus and 401(k) plans
- Acknowledgment of executive's right to COBRA continuation coverage
- Address Stock Options (if applicable). Example: "Any Stock Option held by the Employee may hereafter be exercised, to the extent it was exercisable on the date of separation, for a period of one year from the date of the Employee's Separation, or until the expiration of the stated term of the Stock Option, whichever period is shorter, and to the extent not exercisable on the date of separation such Stock Option shall be forfeited".



# Key Considerations For Severance Agreements

- **Additional Key Terms (cont'd):**
- Include **General Release** of Claims:
  - Identification of Released Parties
  - Comprehensive description of claims released
    - o Claims Under Federal, State and Local Anti-discrimination statutes
    - o Tort and contract claims
    - o All claims arising out of employment with company, any claims that relate to design or administration of any employee benefit programs, and any claims that employee has rights to severance or similar benefits or to post-employment health or group insurance benefits, or any claims to attorney's fees.
- Acknowledgment that employee is NOT releasing any claim that relates to right to enforce agreement, any right to unemployment benefits, or any claims arising after signing of agreement.



## Key Considerations For Severance Agreements

- **Additional Key Terms (cont'd):**
- Confirm and state exact date of separation of employment and effective date of the agreement.
- Waiver of right to reinstatement or future employment with Company or any released party
- Acknowledgment of no claims filed and promise not to file suit based on claims released
- Promise not to seek damages after filing a charge with an administrative agency (such as EEOC)
- Acknowledge that nothing in agreement prohibits employee from filing administrative charge or cooperating with agency's investigation of such charge.



## Key Considerations For Severance Agreements

- **Additional Key Terms (cont'd):**
- Promise to return all Company property
- Acknowledge that Company has provided employee with any unpaid leave to which he may be or have been entitled under FMLA
- Agreement to cooperate with Company in defense or prosecution of claims relating to occurrences while executive was employed with Company.
- Acknowledge employee's responsibility for payment of taxes
- Non-disparagement agreement (but be mindful of EEOC's position that this can't prevent employee from filing charge)



# Key Considerations For Severance Agreements

- **Additional Key Terms (cont'd):**
- Consequences for Violating Employee's Promises: Attorney's fees and damages
- Review, Revocation and Tender Back – Required for compliance with Older Workers Benefit Protection Act (“OWBPA”) for release of age discrimination claims for employees who are 40 years of age or older
  - Right to revoke within 7 days of date employee signed agreement
  - Acknowledge that employee was given 21 days in which to consider signing agreement, and that if not signed within the 21 day period, the agreement will expire and no longer be available



## Key Considerations For Severance Agreements

- **Additional Key Terms (cont'd):**
  - Must include language specifically advising employee to consult with an attorney prior to signing the agreement
- Non-admission of liability and acknowledgment that agreement may not be used as evidence
- Specify state law that will govern interpretation and enforcement of agreement (the State that has substantial relationship to the parties, such as State of incorporation of Company, or where employee worked, or where agreement is signed)



## Key Considerations For Severance Agreements

- **Optional Terms & Considerations:**
- Potentially include offer of outplacement counseling or reimbursement of job search expenses
- Consider requiring arbitration for enforcement rather than through the courts
- If there is existing, valid non-compete agreement, consider referencing it in severance agreement and confirming that non-compete obligations continue
- If not, consider including limited non-compete within agreement, that includes agreement to refrain from solicitation of accounts or employees or employee information.



## Key Considerations For Severance Agreements

- **Optional Terms & Considerations (cont'd):**
- Be aware of Texas Business & Commerce Code key language: “[A] covenant not to compete is enforceable if it is ancillary to or part of an otherwise enforceable agreement at the time the agreement is made to the extent that it contains limitations as to time, geographical area, and scope of activity to be restrained that are reasonable and do not impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee.”
- Consider also including agreement to continue to preserve and not to disclose confidential and proprietary information (Executive employee already has a common law fiduciary duty not to disclose confidential information, but it would be best to clarify and confirm)





## Firing Executives for Cause Under An Employment Contract – A Case Study

- If “Cause” exists, an executive’s employment agreement almost always provide that the executive will receive no severance benefits – i.e. no post-termination salary and health insurance benefits continuation, less commonly, accelerated vesting of stock.
- “Good Reason” – allows executive to leave, but still receive severance benefits.
- In practice, companies rarely fire executives for Cause and deny all severance. Even when a company is dissatisfied with an executive’s performance or conduct, it is generally in best interest of company to negotiate reduced severance benefits in a separation agreement.



## Firing Executives for Cause Under An Employment Contract – A Case Study

- *Eric Balles v. Babcock Power* (Mass. Judicial Court, 2017)
- Babcock fired Balles (the Executive) for “Cause” after it discovered that he was having an extramarital affair with a young female subordinate.
- The Company’s Board of Directors invoked the termination provisions of the Executive’s stockholders’ and employment agreements to repurchase his stock at a minimal price, to withhold almost \$900,000 in dividends and to refuse to pay the Executive any severance.
- The trial court ruled in favor of the Executive by concluding that he was not fired “for Cause” and an appeal followed.



## Firing Executives for Cause Under An Employment Contract – A Case Study

- *Eric Balles v. Babcock Power* (cont'd)
- The appeals court agreed with the trial court that the Executive's conduct did not constitute fraud or gross insubordination (which was included in the definition of "Cause") and that he did not violate any direct order.
- The appeals court also rejected company's argument that it did not have to provide Executive opportunity to correct his conduct because the company had not shown that his breach was "intrinsically incapable of correction."
- If definition of "Cause" had been broader, probably would have been different outcome.



## Deferred Compensation Agreements

- *Section 409A, Internal Revenue Code*
- Severance pay and benefits provided to an executive commonly include cash payments and continued medical and other benefits for a specified period of time after termination.
- Structuring severance so as to qualify under one or more exceptions to Section 409A generally will be the preferred course of action since it allows the future flexibility to accelerate payments or benefits and/or substitute other Section 409A exempt payments and benefits for the severance.