

Representing the Executive*

Wayne N. Outten
Outten & Golden LLP
New York, New York

This chapter addresses various aspects of executive employment and compensation from the point of view of an attorney representing executives.¹ "Negotiating Employment Agreements" covers the negotiation of employment contracts at the beginning of the employment relationship, including compensation and benefit issues. "Handling Disputes Involving Current Executives" covers advising and representing executives regarding employment problems and disputes during the employment relationship. "Negotiations and ADR in Employment Disputes" discusses dispute resolution approaches for disputes between employers and executives, whether during or after the employment relationship. Finally, "Negotiating and Drafting Settlement Agreements" covers the negotiation and drafting of settlement and severance agreements between employers and executives at or after the end of the employment relationship.

I. Negotiating Employment Agreements

Agreements between an employer and an executive have been thoroughly analyzed and discussed in earlier chapters; however, those discussions are generally applicable to issues that the employer needs to consider and raise. This chapter emphasizes and, in at least some cases, recaps what the executive, with the aid of his or her attorney, should focus on. The chapter, for ease of reference, presents these particular issues in one place.

A. Introduction

Since the 1990s, formal written employment agreements have become increasingly common, especially for executives, technical experts, finance experts, and top sales and marketing people. In 2005, according to a report produced by a human resources consultancy group, an average of 46.4 percent of senior executives had employment agreements. Further, according to a research group that tracks executive compensation, about 60% of executives leading companies in the Standard & Poor's 500-stock index had

* Reproduced with permission from Benefits Practice Center, Executive Compensation Library, Executive and Director Compensation Reference Guide, <http://www.bna.com/products/eb/bpcw.htm>. Copyright 2007 by The Bureau of National Affairs, Inc., (800-372-1033), www.bna.com.

¹ Whereas some topics addressed in this chapter may be covered elsewhere in the guide, the discussion in this chapter is intended to supply complete coverage from the plaintiff's/executive's perspective. However, readers should consult the chapters *Negotiating Employment Contracts*, for an overview of negotiating executive employment agreements, *Executive Severance Agreements* for additional discussion of severance agreements, and *Alternative Dispute Resolution in the Executive Employment Context* for more complete discussion of alternative settlement approaches.

employment contracts in 2004.²

Given the employment-at-will rule in the United States, employment agreements containing such terms as a fixed term of employment, "good cause" for termination, notice of termination, and/or minimum severance pay are generally more desirable for executives than for employers. Even so, employers sometimes want employment agreements to serve their interests, for example, to impose restrictive covenants limiting an executive's ability to compete or to solicit clients or employees.

In a tight labor market, with employers competing for top talent, executives have more leverage to insist on firm, written commitments regarding compensation, job security, severance pay, and other terms of employment. This is especially true when an employer is trying to lure an executive away from a secure or lucrative position or trying to relocate an executive to a new area. Moreover, the compensation packages for many executives include not only cash and stock bonuses but also equity grants (e.g., restricted stock and stock options), deferred compensation, and other interests that vest over time. An employment agreement can ensure and secure those interests during and after the employment.

Before detailing the provisions of employment agreements, the role of the attorney representing the executive should be addressed. Although an executive might obtain a fair employment agreement without an attorney, the odds are against it.

Invariably, the employment agreement will be drafted by the employer's counsel, typically using a model that the attorney has used for other employers (if the attorney is an outside counsel) or has used for other executives of the employer. In any event, that document is rarely balanced or sufficiently protective of the executive's interests.³ Thus, the executive's attorney can make a significant difference in the negotiation and drafting of the terms and language of the agreement. A qualified attorney can almost always help an executive get a better, stronger agreement than would otherwise be the case.

B. Types of Issues Covered in Employment Agreements

In negotiating employment agreements, two broad categories of issues can arise: business issues and legal issues. The two categories are not very distinct, and they often overlap. However, the use of these categories can be helpful in analyzing issues that should be discussed with clients and opposing counsel.

The basic business issues include the duration of the employment agreement; the executive's title, duties, and responsibilities; the basic compensation package (e.g., base salary, bonuses, commissions, and/or other incentive compensation); the basic benefits (e.g., health insurance, disability and life insurance, and vacation); and special compensation arrangements (e.g., stock options, restricted stock, deferred compensation, and supplemental retirement benefits). Other business issues might include "perquisites" (car allowance, club dues, financial counseling, and tax return preparation), relocation packages, and expatriate benefits.

The basic legal issues include renewal or extension of any fixed term; grounds for early termination by the employer (e.g., death, disability, or for "cause") or the executive (e.g., for "good reason"); the effect, if any, of a change of control; definitions of such terms as cause, good reason, and change of control; the effect of early termination on bonuses, unvested stock, stock options (including the length of time to

² The Hay Group, 2005 Hay Group Benefits Prevalence Report, results reprinted in CAREER JOURNAL: EXECUTIVE CAREER SITE at <http://www.careerjournal.com/salaryhiring/industries/seniorexecs/20050920-perq-tab.html>. See also, Joann S. Lublin, Many Top-Level Executives Lack Employment Contracts, CAREER JOURNAL: EXECUTIVE CAREER SITE (Nov. 1, 2004) at <http://www.careerjournal.com/salaryhiring/industries/seniorexecs/20041112-lublin.html>.

³ A notable exception is the "golden parachute" agreement crafted for the specific purpose of benefiting senior executives in the event of a change of control. "Stay" or retention bonus agreements are sometimes drafted in a pro-executive manner as well.

exercise after termination), deferred compensation, and other aspects of compensation and benefits; the amount and type of severance compensation under various scenarios; the nature and scope of restrictive covenants, especially a covenant not to compete; the amount and nature of notices required to be given; dispute resolution (i.e., mediation, arbitration, forum, governing law, and so forth); remedies for breach, including injunctive relief, liquidated damages, and attorneys' fees and costs; and a broad array of "boilerplate" provisions (e.g., integration clause, warranties and representations, nonwaiver clause).

Of course, the attorney is responsible for ensuring that the language of the final employment agreement fully, accurately, and clearly sets forth essential terms of the arrangement, whether they are "business" or "legal" terms.

Typically, the executive already has negotiated at least the general outlines of the business terms before contacting an attorney. Some executives, however, consult counsel before beginning such negotiations or consult counsel early in the process. Early counseling can be very helpful in planning the negotiation and structuring the business terms, even with a sophisticated client. Generally, the earlier the executive consults counsel, the better.

Moreover, at such a stage, some executives and their counsel use compensation consultants. With the use of publicly available information, survey results, and other information that may not be readily available, consultants can advise on the nature and amount of compensation and benefits others are getting in the same industry or in comparable types of businesses.

These consultants can be especially helpful in structuring sophisticated equity-based compensation packages for senior executives. For example, they can show what percentage of the equity of a start-up or early-stage company other chief executive officers have been granted in similar situations or how many stock options they have received. In addition, these consultants sometimes have specialized knowledge in the tax, securities, and ERISA issues that arise in some executive employment agreements.

Even when the executive consults counsel after the basic business terms have been negotiated, counsel can help the executive with business terms, perhaps by suggesting grounds for renegotiation or by adding new substantive terms not already addressed. Thus, the attorney may stay in the background while advising the client to continue or renew negotiations with the employer on various business terms. This can be advantageous to the executive in number of ways.

- First, the executive and the employer are the ones best able to evaluate and make business decisions about the job.
- Second, the executive is far better able than the attorney to compare and contrast the many aspects of alternative job prospects.
- Third, direct discussions between the executive and the employer can help flush out any areas of actual or potential disagreements about the job, compensation, and other expectations of the parties.
- Fourth, direct discussions can help foster the relationship between the executive and the employer.
- Fifth, the executive can sometimes negotiate better business terms directly than the attorney could, given the more personal connection between the executive and the employer.
- Sixth, the executive can keep attorneys' fees lower by engaging in direct negotiations over the business terms.

Typically, once the basic business terms are set, the employer's counsel will prepare and present a proposed employment agreement, which the executive's counsel will then review. It is at this stage, if not before, that the executive's attorney focuses on the legal issues and perhaps business issues that were not adequately or properly covered in the negotiations or the proposed agreement.

To do that job, the attorney must not only review the agreement very carefully but must spend time with the client discussing, for example, the nature of the position, the elements of compensation, expectations for the future, and how risk averse the client wants to be, in order to understand how best to serve the client's interests under the agreement. Ultimately, of course, the client has to decide how much he or she wants the job, given the deal offered and the alternatives available.

The executive's attorney needs to know what to look for, what the key issues are, what terms and conditions are typical, what the typical range of outcomes is on particular issues, what traps for the unwary exist, and what legal, regulatory, and practical constraints apply to certain topics. This chapter will try to highlight these issues, with more emphasis on the legal issues than the business issues.

C. Basic Threshold Provisions

1. Term

An employment agreement can have a fixed or indefinite term. In many respects, it does not matter which it is. There are two key issues: (1) Under what circumstances can the employment be terminated? (2) What are the consequences of termination under the various circumstances?

With a fixed-term agreement, the initial consideration is what happens at the end of the term. Under the laws of some states, an employment agreement is automatically renewed either for the period of the initial term or for one year, unless the agreement provides otherwise. In other states, the agreement expires, unless the agreement provides otherwise. In any event, the careful attorney should ensure that the agreement specifically addresses what happens at the end of the term.

Many agreements have a default provision to the effect that, if neither party gives notice to the other a certain number of days before the expiration date, the agreement will renew automatically for another year. Such a provision ensures that the agreement stays in effect if neither party remembers or decides to end it. On the other hand, some agreements provide that the agreement will end unless one party gives notice of renewal and the other party does not object within a certain period before expiration. Some agreements provide that the parties agree to discuss in good faith the renewal or extension of the agreement beginning a certain number of days before expiration.

In any event, the executive's attorney should be alert to the consequences for the executive when the agreement expires. For example, if the agreement provides for severance pay or accelerated vesting of options on termination without cause by the employer during the contract term, what happens to those provisions if the agreement simply expires but the executive keeps working? If the severance and vesting provisions expire, the executive may lose expected benefits. The solution may be a provision that such provisions survive the expiration of the agreement.

Fixed-term agreements typically provide for early termination under certain circumstances, such as death, disability, termination by the employer for cause, and termination by the executive for good reason.

Many employment agreements are of indefinite duration, meaning that they continue until terminated by death or by action of either party. These agreements sometimes provide that either party can terminate at any time for any reason. They may even have a provision allowing the employer to terminate the executive at any time (or after a certain period) without cause, with certain consequences. Under such agreements, the key issue for the executive is what happens on termination under various circumstances. Grounds for termination and the consequences of termination on each ground will be discussed in "Termination and Severance Provisions," below.

2. Position

The employment agreement should identify the executive's job with as much specificity as possible. In addition to the job title, the duties, responsibilities, and authority that go with that job should be described, and the executive's immediate boss and (when appropriate) where the executive will work should be identified. If the scope of the executive's duties, responsibilities, or authority may be an issue, a comprehensive job description may be attached as an exhibit to the agreement.

The reason for specificity as to job details is to ensure that the employer does not assign the executive duties and responsibilities that are less attractive or desirable, or that materially diminish the executive's authority or stature, without the executive's concurrence. If the employer does change the executive's

duties, responsibilities, or authority in a way that contravenes the specific terms of the employment agreement, the executive may have a claim for breach of contract. Moreover, the executive may have the right to treat any material diminishment of the job as grounds to resign for "good reason" (which is discussed in "Termination and Severance Provisions," below). The more specific the job description, the more likely the executive can establish breach of contract or grounds to resign. In any event, a careful discussion of this topic may flush out areas of ambiguity or disagreement.

Employers sometimes include language to the effect that the executive will undertake "such other or different duties as the employer (or a particular officer or the board) shall direct." Under such a provision, the employer could effectively demote the executive to an inferior position, perhaps in an effort to get the executive to quit. Obviously, such an open-ended provision should be resisted. At a minimum, such a provision should be qualified so that any other or different duties are consistent or commensurate with the job specified in the agreement.

3. Salary

The amount of the salary is a business issue for the executive to decide, although the executive's attorney might be in a position to opine as to whether the salary seems in line with the salary paid to others similarly situated. In addition, the agreement should provide for periodic reviews, perhaps with built-in increases of certain amounts; the agreement should, at a minimum, provide that the salary cannot be decreased. The main job of the attorney here is to ensure that the amount of the salary and the periodicity of payment are stated clearly and accurately.

Other than minimum wage and overtime laws and state statutes on how frequently employees must be paid, few restrictions apply to salary terms. A notable exception is §162(m) of the Internal Revenue Code, which provides that employers cannot deduct compensation to certain covered executives of publicly traded companies to the extent that the compensation (including salary and bonuses) exceeds \$1 million per year. Certain "performance-based" compensation is not, however, subject to the \$1 million deduction limit.

4. Incentive Compensation

The amount of incentive compensation and the standards for earning it are, generally, business issues for the executive. Nonetheless, the lawyer often can help the executive obtain better assurance of full and fair bonuses.

Many large companies have incentive compensation plans that outline under what circumstances executives earn what bonuses. The executive and the executive's attorney should review carefully any such plans mentioned or relied on in the employment agreement, if for no other reason than to make sure the executive understands how the plans work. Moreover, the executive may be able to obtain beneficial clarifications, enhancements, or guarantees under the applicable plans.

Proposed employment agreements often provide that incentive compensation be at the discretion of the employer. Obviously, that can be quite problematic for the executive, given that the employer could exercise its discretion to give little or no bonus. For a new executive, this may be an unacceptable risk. Thus, it is often possible to negotiate a guaranteed or minimum bonus for the first year or two of employment, especially when the executive is leaving behind some bonus pay at the prior employer.⁴

⁴ The executive may be able to negotiate a "signing bonus," or "make whole bonus," with the new employer, particularly when the executive is leaving behind bonus pay or unvested equity interests from the prior employer. Such bonuses are common for jobs such as investment bankers, in which bonuses constitute a high percentage of the executive's total compensation. Sometimes, employers contend that all or part of the signing bonus should vest over a period of time or should be forfeited if the executive leaves the new job within a certain period of time. (Note that IRS Notice 2004-109 takes the position that certain sign-on bonuses entered into after Jan. 12, 2005, will be considered taxable wages for purposes of FICA, FUTA, and federal income tax withholding. For further discussion of sign-on bonuses, see

Moreover, the executive may be able to get the employer to replace a discretionary or subjective bonus with one based on clear objective goals, whether for the executive's own performance, for the executive's department or division, and/or for the company as a whole. For example, such goals might consist of the company or the department achieving a specific increase in share price; a certain level of revenues; profits; or earnings before interest, taxes, depreciation, and amortization (EBITDA), or a certain percentage of budget. The goals might also pertain to the executive's own personal performance, such as a certain number or amount of sales. When such objective goals cannot be set forth in the employment agreement, an alternative is to provide for the employer and the executive to agree on objective goals before or early in the applicable period.

Consideration should be given to bonuses for partial years at the beginning or end of the employment. The agreement should make clear how the bonus will be determined for the initial year and should address whether the executive will get a full or prorated bonus for the final year, especially if the executive has achieved or largely achieved bonus objectives. The latter subject is typically addressed in the severance pay portion of the employment agreement.

5. Benefits and Perquisites

The executive should obtain copies of any benefit plans and policies to understand how they will apply to the executive. Often, the benefits provision in an employment agreement will provide simply that the executive will receive the same benefits as other executives of the same or comparable rank. This may be sufficient, if the executive understands generally what those benefits are or will be.

Occasionally, particularly when the employer's benefit plans are not fully developed, the executive may seek to obtain a "most favored nations" clause, assuring that the executive's benefits will be at least as good as those of a designated person or group.

Of course, if the employer has promised any special benefits to the executive beyond those customarily provided to others, the employment agreement should so specify. For example, the executive might negotiate more life insurance coverage, more disability benefits, or more vacation time than is standard. If such arrangements are not set forth in an integrated employment agreement, they may be unenforceable.

6. Special Compensation Arrangements

Senior executives often obtain special compensation arrangements, such as deferred compensation and supplemental executive retirement plans (SERPs). Sometimes, these arrangements are set forth in plans applicable to certain executives or categories of executives, typically the most senior executives.

Such plans are nonqualified, meaning that they do not qualify under the Internal Revenue Code for special tax treatment.⁵ However, they can enable executives to defer the receipt of compensation—and therefore the payment of income taxes on such compensation—until they have left the employer, perhaps on retirement, when the executive's income and tax rates probably will be lower. Such deferred compensation amounts typically accrue earnings and/or appreciation until paid out.

The executive should be aware, however, that to avoid current taxation, the deferred compensation must remain a liability of the employer.⁶ The foregoing is true whether or not the employer sets aside funds

Negotiating Employment Contracts.)

⁵ Such plans are generally subject to §409A of the Internal Revenue Code, added by the American Jobs Creation Act of 2004, Pub. L. No. 108-357, and generally effective Jan. 1, 2005. See the chapter *Nonqualified Deferred Compensation Plans* for a discussion of §409A and related agency guidance.

⁶ For discussion of legal and practical considerations for deferred plans, see *Nonqualified Deferred Compensation Plans*.

currently to meet its future obligations (e.g., places funds into a "rabbi trust"). In either situation, the executive will be merely an unsecured creditor of the employer.

A deferred compensation arrangement need not be set up or governed by a plan of general applicability. It may be created by an employment agreement for a particular executive. Like a deferred compensation plan, such a deferred compensation arrangement is simply a contractual commitment by the employer to make certain payments at certain times in the future.

Notably, deferred compensation may be subject to vesting and forfeiture provisions. Thus, an executive who quits or is fired for cause may not get part or all of the deferred compensation. The executive's attorney should try to obtain protection against such potential loss by providing in the agreement for accelerated or continued vesting under appropriate circumstances.

D. Equity-Based Compensation

Many employment agreements include equity-based compensation, such as restricted stock, stock options, phantom stock, and stock appreciation rights (SARs).⁷ These arrangements are used by employers for two basic purposes: first, to provide "handcuffs" to keep executives from leaving before the vesting of equity interests and, second, to provide an incentive for performance by rewarding executives for future appreciation in the price of the employer's stock, whether privately held or publicly traded. Equity-based compensation raises many complex legal, tax, securities, and accounting issues, discussion of which, while beyond the scope of this chapter, are highlighted below.

Equity-based compensation is often the key attraction for an executive to join and stay with a particular employer. Indeed, some executives give up secure positions with good pay to accept jobs at lower rates of pay—but with the opportunity to participate in anticipated increases in the company's stock price. This phenomenon has been common with start-ups and emerging companies, especially those with a realistic chance of an initial public offering in the foreseeable future.⁸

Stock options are a common form of equity-based compensation. Incentive stock options (ISOs) meet certain requirements under the Internal Revenue Code and therefore receive favorable tax treatment. Nonqualified stock options do not receive favorable tax treatment but are not subject to the restrictions that are applicable to ISOs under the tax code. For example, when an executive exercises an ISO (i.e., buys the stock at the exercise or strike price set when the ISO was granted), the executive does not recognize any taxable gain on the difference between the exercise price and the fair market value at the time of exercise. The executive pays taxes only when the stock is sold at a profit. Moreover, if the executive holds the stock for more than two years after the date of the option grant and more than one year after the exercise date, any profit on sale will be taxed as a long-term capital gain, not as ordinary income.

Among the restrictions on ISOs are the following: the exercise price cannot be lower than 100 percent of the fair market value on the date the option was granted;⁹ the maximum amount in which any executive can vest is \$100,000 worth of options per year (determined at the time of grant); and the term of the option cannot exceed 10 years.

⁷ For further description of these kinds of arrangements, see *Using Equity to Compensate Executives*. For discussion of legal considerations under §409A, see *Nonqualified Deferred Compensation Plans*.

⁸ For discussion of issues important in start-ups, see *Executive Compensation Issues for Emerging Companies*.

⁹ For 10 percent shareholders, the exercise price must be at least 110 percent of the fair market value at the time of the option grant.

With a nonqualified stock option (NSO), on the other hand, the executive will recognize a taxable gain to the extent that the fair market value exceeds the exercise price at the time of exercise (even if the executive does not sell the stock then) and the gain is taxed as ordinary income; even so, any appreciation in the value of the stock between the date of exercise and the date of sale will receive capital gains treatment.

Under I.R.C. §409A, the use of NSOs has become more restricted.¹⁰ Discounted NSOs that are "in the money" (i.e., the exercise price is less than the market price at the time of grant) are considered deferred compensation and subject to §409A. Section 409A requires that the schedule for payout of deferred compensation is defined well in advance and imposes significant penalties for certain changes to the payout schedule or for acceleration of vesting.

Phantom stock and SARs are not really stock at all. The executive owns no stock and has no voting rights as a stockholder. Rather, the executive is entitled to payment (typically in cash, although sometimes in stock) based on the price of the employer's stock (phantom stock) or the appreciation in the price of the employer's stock (SARs) during the relevant period.

The executive and the executive's attorney should obtain and review whatever plans govern any stock grants, stock options, phantom stock, and other equity-based compensation. Notably, equity-based compensation grants do not require formal plans—they could be creatures of contract—although they usually are set forth in one or more plan documents.¹¹ When a plan sets forth the general terms of an equity-based vehicle, a separate agreement is usually prepared and executed at the time of the initial grant and each subsequent grant, in which the terms of the particular grant are set forth.

The executive's attorney should compare the terms of the stock plan, the agreement pertaining to each grant, and the terms of the employment agreement to ensure consistency. Any differences should be clarified. It may be advisable in certain circumstances to insert language into the employment agreement stating that the terms of that agreement prevail over any inconsistent terms in the grant agreement or in the underlying plan document; sometimes, negotiation over such provisions may lead to changes in the grant agreement or even the plan itself.

The executive and the executive's attorney should focus very closely on the vesting of equity grants. For the executive, the more quickly the vesting occurs the better. For the employer, on the other hand, slower vesting is preferable; unvested shares and options can provide "handcuffs" to keep executives from departing when the employer wants executives to stay, particularly when unvested options are "in the money" (i.e., the current stock price is higher than the exercise price).

Typically, stock grants and options vest ratably over time, usually one to five years. Such vesting might be annually, quarterly, or monthly; generally, executives benefit from the shorter intervals of vesting. The vesting of some options (e.g., performance-based options) is based not on the passage of time but on the achievement of certain goals, such as a certain level of financing or revenues.

Generally, the executive or the executive's lawyer should try to negotiate accelerated or continued vesting of all unvested stock and stock options if the employer terminates the employment without cause or the executive quits for good reason. As a fallback, they may be able to obtain accelerated or continued vesting for some period, say one year from the date of termination.

The period for exercise of vested options after termination of employment should also be examined. Some option agreements and employment agreements provide that an executive's vested options expire immediately on termination for cause or resignation without good reason and expire within a short period (e.g., 30 or 90 days) after termination for other reasons.

Obviously, such provisions can jeopardize the executive's ability to realize a gain on the options if the

¹⁰ For discussion of the application of §409A to NSOs, see *Nonqualified Deferred Compensation Plans*.

¹¹ If an equity-based plan is considered nonqualified deferred compensation, it may be subject to I.R.C. §409A and may have to meet that section's documentary requirements. See the chapter *Nonqualified Deferred Compensation Plans*.

options expire before they can be exercised or if the options are "underwater" (i.e., the exercise price exceeds the current stock price) during the shortened exercise period. The solution is to try to obtain at least a modest period (e.g., 30 days) to exercise even in the event of termination for cause or resignation without good reason and an ample period (e.g., 90 days to one year) to exercise in other circumstances. It is common to provide a lengthy period for the estate of a deceased executive to exercise after termination of employment due to death.

The executive's attorney should also consider "tag along" and "drag along" rights in certain situations. Basically, with a tag-along right, the executive-shareholder has a "put"—a right to force the purchase of his or her equity interest—if a majority shareholder sells its interest. By contrast, under a drag-along right, a majority shareholder has a "call"—a right to force the executive-shareholder to sell—if the majority shareholder sells its interest.

E. Termination and Severance Provisions

Generally, termination and severance provisions are among the most important provisions in an employment agreement. For a fixed-term contract, these provisions govern early termination of the agreement. For an indefinite-term contract, these provisions govern when and how the term of the agreement will end. Moreover, the severance provisions govern what the executive will get under various scenarios.¹²

The employer's proposed employment agreement typically will address the following as grounds for termination of the agreement: death, disability, retirement, and termination by the employer for cause. The executive's attorney should try to add termination by the executive for good reason.

Employment agreements typically provide that, when the executive dies, the employer's only obligation under the agreement is to pay to the executive's estate any accrued salary and accrued unused vacation pay. The executive's attorney may try to add payment of accrued but unpaid bonuses and a prorated bonus for the final year of employment. The agreement may also provide for a specified amount of life insurance coverage.

The issues relating to termination and payments on disability are similar to those relating to termination and payments on death, except that the executive may be entitled to certain disability benefits after termination, which may include continued vesting of equity interests. Moreover, executives often can obtain continuation of certain benefits, particularly health insurance, at the employer's expense for some period after termination due to disability.

The employment agreement should contain a definition of "disability." From the executive's perspective, the definition should be fairly stringent, so the employer cannot terminate the executive too readily. The typical definition of disability provides that the executive will be deemed disabled after a certain number of consecutive days (e.g., 60 days) of inability to perform the job and/or after a certain number of days within a set period (e.g., 180 days during a one-year period). The language should be crafted to ensure that the termination date does not occur until the end of the relevant period, even if the parties know before then that the executive will not be able to return to work.

Retirement is generally treated the same as death, except that the executive may be entitled to certain retiree benefits after termination, which may include continued vesting of equity interests. Moreover, retiring executives often can obtain continuation of benefits, particularly health insurance, at the employer's expense, especially if they meet certain age and/or service thresholds.

The executive's attorney should focus very intently on the provisions concerning termination by the employer for cause. These provisions can have a major impact on the executive's rights on termination to salary, benefits, severance pay, and vesting of deferred compensation and equity interests.

In short, the attorney should try to make the definition of "cause" as narrow as possible. Typical elements

¹² For additional discussion of severance, see *Executive Severance Agreements*.

of cause include conviction of a felony or other crime involving moral turpitude, loss or suspension of any necessary licenses, breach of company policies, failure or refusal to perform the duties of the job, insubordination, and breach of contract by the executive. For each of these, the executive's attorney should seek to include, to the extent applicable, qualifiers regarding the executive's state of mind and the nature and extent of the executive's conduct. Thus, for example, words like "material" or "substantial" should be inserted before nouns like "breach," and words like "willful," "intentional," or "knowing," "repeated," or "persistent" should be inserted before nouns like "breach" and "failure." Of course, the executive's attorney should resist vigorously an employer's efforts to include words like "discretion" and "satisfaction" that give the employer too much room for discretionary and subjective decisions.

The executive and the executive's attorney should try to establish the ability of the executive to resign for a good reason, with such a termination being treated like a termination by the employer without cause—similar to constructive discharge.

Such "good reasons" might include: a material diminution in the executive's title, duties, responsibilities, authority, compensation, or benefits; a requirement to relocate beyond a certain area; the employer's breach of the contract; or a change of control. A "change of control" definition might include a merger or sale of a majority of the company's stock, sale or transfer of all or substantially all of the company's assets, a major change in the composition of the board of directors, or the departure of a designated person as a controlling shareholder, board member, board chair, CEO, and so forth.

For tax-treatment reasons, the drafters of §409A's regulations have advised that the agreement should be drafted with separate provisions for "involuntary termination without cause" and "voluntary resignation for good reason." Under proposed regulations, § 409A treated payments made as a result of a "voluntary resignation for good reason" termination as suspect, given that the control over the termination was in the hands of the executive rather than the employer, and therefore subjected it to scrutiny in determining its §409A treatment. The IRS and Treasury have provided more guidance in the final regulations on what will be considered a "good reason" termination that is not a subterfuge for avoiding inclusion in §409A, as well as safe harbor definitions that may be specified in the plan document.¹³

Generally, the good reasons should be defined as resulting in a "material negative change" in the employment relationship, and should not result in payments upon separation from service being different in form and amount from payments that would have been made upon an actual involuntary separation from service. For purposes of the safe harbor provision, a good reason termination will be treated as an involuntary termination if the termination occurs during a pre-specified period of time and meets certain requirements, including a "material diminution" of certain responsibilities as enumerated in the regulations, a 90-day notice to the employer of the adverse conditions, and a 30-day cure period in which the employer may remedy the conditions.¹⁴

It is prudent to draft these provisions conservatively to meet the safe harbor provisions of the final regulations. By contrast, certain payments made as a result of an "involuntary termination without cause" are deemed exempt from §409A so long as they fall into the exemptions delineated under the regulations.¹⁵

In addition to including the regulatory safe harbor's notice provisions that run from the executive to the employer, the executive and the executive's attorney should try to include a comparable provision requiring the employer, before terminating for cause, to give the executive adequate written notice of the proposed action and a reasonable opportunity to cure. Such a provision need not apply to grounds that are not curable (e.g., conviction of a felony) but are especially appropriate for grounds that are curable and somewhat subjective, such as failure to perform or breach of contract. The notice should identify the specific provision(s) of the cause definition being relied on and should describe with specificity the conduct of the executive that is the basis for the proposed termination. The cure period may be described

¹³ See preamble to the final regulations at III.J.3, 72 Fed. Reg. 19,234, at 19,247 (April 17, 2007).

¹⁴ Treas. Reg. §1.409A-1(n)(2)(i).

¹⁵ See Treas. Reg. §1.409A-1(b)(9)(i), (ii), & (iii).

as "reasonable," but a specific ample period of time (e.g., 30 days) is preferable to avoid dispute. A cure provision serves not only to provide information and protection for the executive but also to limit rash and arbitrary conduct by the employer.

The executive's attorney should also be aware of the punitive excise taxes imposed on certain "golden parachutes" that are triggered by a change of control.¹⁶

F. Restrictive Covenants

Books can be and have been written about the many types of restrictive covenants that employers include in employment agreements, severance agreements, and other agreements with executives. Such restrictive covenants include confidentiality and nondisclosure agreements and agreements not to compete or not to solicit clients and employees. A discussion of such agreements is beyond the scope of this chapter.¹⁷

The executive's attorney should be conversant with the case law (and any relevant statutes) regarding restrictive covenants in applicable jurisdictions. The foregoing is especially important with regard to a state's policy and law on the enforceability of noncompete clauses. Such laws vary considerably from state to state.

Obviously, the executive's counsel will try to make any such covenants as narrow and reasonable as possible. Generally, fairly broad confidentiality and nondisclosure agreements are not objectionable; in fact, some of the strictures contained in such agreements may exist as a matter of law anyway. Moreover, in most contexts, executives do not object to broad agreements providing for the employer's ownership of any copyrights, patents, and the like that arise out of or during the employment relationship. Thus, except in special circumstances, little energy needs to be focused on such provisions.

Usually, the main concerns of the executive pertain to noncompetition and nonsolicitation clauses; these clauses can seriously limit the executive's ability to earn a living after leaving the employer. Such provisions have become common, as employers seek to limit competition and protect their confidential, proprietary, and trade secret information. The executive and the executive's counsel should focus carefully on the language proposed, evaluate how that language, if enforced, might affect the executive's postemployment ability to work, and then negotiate for narrower, clearer, and fewer limits. For example, generally a noncompete clause should not prevent the executive from working for a competitor of the employer if the executive's own activities are not competitive.

One area for possible focus is the impact of the grounds for termination on the noncompete clause. The executive may negotiate for a provision that, if the employment is terminated by the employer without cause or by the executive for good reason, the noncompete clause will not apply or will apply for a shorter period or with a narrower scope.

Moreover, the duration of the noncompete period can be linked to severance pay. For example, the employer or the executive may have the option to shorten the noncompete period by ceasing or waiving severance payments.

G. Dispute Resolution

A comprehensive employment agreement should include a dispute resolution provision setting forth what

¹⁶ See I.R.C. §§280G and 4999.

¹⁷ For further information, see ABA Section of Labor and Employment Law, COVENANTS NOT TO COMPETE: A STATE-BY-STATE SURVEY (Brian M. Malsberger, et al. eds., BNA Books 6th ed. 2006).

forum will address any disputes that arise under the agreement.¹⁸

Although mandatory arbitration of statutory discrimination cases is abhorrent to employees' attorneys, arbitration of contractual disputes is not. Indeed, arbitration of contractual disputes has many relative advantages for executives, including speed, cost, and finality. The executive or his or her counsel should consider suggesting such a provision if the employer does not include one in the initial draft.

Moreover, it is a good idea for the dispute resolution provision to have three steps:

- (1) good faith discussions for a reasonable but short period;
- (2) mediation using an agreed-on (preferably named) mediator or mediation provider; and
- (3) arbitration using a named arbitrator or arbitration provider (such as the American Arbitration Association (AAA) or JAMS). Of course, the parties could agree to engage in the first two steps (and even the third) once a dispute has arisen; however, including such a provision in the agreement may help initiate early discussions and possible early resolution of the dispute.

The initial issue to address in the dispute resolution provision is its scope. Does it apply to disputes arising from or relating to the agreement only or to all disputes arising from or relating to the employment relationship, including the termination of that relationship? The latter language is much broader and would encompass statutory and tort claims as well as contract disputes.

Another issue is location. Employer's standard agreements sometimes provide for any mediation or arbitration to take place in the jurisdiction of the company's headquarters or a regional office. For the executive, the preferred site is near the executive's workplace or home.

Dispute resolution provisions sometimes are silent on who pays for mediation or arbitration; sometimes, they provide for equal contributions. Of course, the executive generally prefers for the employer to bear all or most of the cost of such proceedings. In any event, it is advisable to include a statement that the arbitrator may or shall award costs and expenses to the prevailing party.

In addition, the executive and the executive's counsel should try to include a provision that the arbitrator has the authority to award attorney's fees to the prevailing party. Absent such a provision, arbitrators generally lack the authority to award attorneys' fees to a prevailing party in a contract dispute, which disadvantages executives relative to employers. On the other hand, a provision *requiring* the arbitrator to award attorneys' fees to a prevailing party could present a risk that the executive may have to pay the employer's attorneys' fees. The best balance for executives is to enable but not require the arbitrator to make such an award.

Other issues include the number of arbitrators (one or three), which state's law governs, and what rules govern. If the AAA is the arbitration provider, its Employment Arbitration Rules and Mediation Procedures should apply.

H. Miscellaneous

Boilerplate provisions at the end of employment agreements typically address some of the following subjects: remedies (including availability of injunctive relief and liquidated damages), governing law, successors and assigns (binding and benefiting successors of both employer and executive), integration and merger, severability, and survival of certain rights.

In special circumstances, executives should seek an assurance of performance of some or all obligations under the agreement from someone other than the employing organization. This could be a personal guarantee by a major shareholder or an endorsement or guarantee by a corporate parent or affiliate. Such an assurance is especially important when the employing organization is new, struggling, or thinly capitalized.

¹⁸ For further discussion, see *infra* on negotiations and alternative dispute resolution in employment disputes. See also generally *Alternative Dispute Resolution in the Executive Employment Context*.

Last but not least, the executive's attorney should try to obtain the employer's commitment to pay the reasonable attorneys' fees incurred by the executive for negotiating the agreement, perhaps with a cap on that amount.

II. Handling Disputes Involving Current Executives

A. Introduction

Representing executives who are involved in disputes with their employers while still employed raises special practical, tactical, procedural, ethical, and legal issues. Most of those issues complicate matters for the executive and the executive's counsel, but some issues are beneficial. Some of those issues arise only in litigated disputes, but most issues arise generally in all disputes, whether or not they are the subject of litigation.

B. Practical Issues

1. Effect on Executives

An executive who is involved in a dispute with his or her current employer typically suffers even more psychological stress and distress during the dispute than an executive involved in a dispute with a former employer. Going to work every day can be extremely uncomfortable and frustrating.

The executive's superiors are usually aware of the dispute, and some may be upset with the executive for being involved in the dispute. This situation is exacerbated when the executive has made allegations against particular superiors, is exacerbated even more when the executive has filed formal charges against or sued the employer, and is especially exacerbated when the executive has filed formal charges against or sued particular superiors.

Moreover, other people in the company, including colleagues, may know about the dispute and have strong opinions about the merits and wisdom of the executive's course of conduct. Some colleagues may be supportive, which can be quite comforting to the executive. Often, however, some colleagues disagree with the executive's position, particularly when it raises issues of the executive's compensation, position, or other treatment relative to others in the workplace or when it threatens to involve the colleagues in the dispute.

In such circumstances, an executive's concerns about a hostile environment, disparate treatment, and retaliation are well founded. These subjects are discussed below.

2. Executive Reaction

Given the circumstances described above, many executives choose not to pursue problems and disputes in the workplace. Rather, they suffer in silence, confide only to persons they can trust, or insist on confidentiality from anyone to whom they disclose the matter.

This syndrome is especially common with disputes that may involve embarrassing or private matters. For example, it is well known that many victims of sexual harassment decide not to disclose the problem or pursue a remedy due to such concerns. Of course, the U.S. Supreme Court's decisions in 1998 in *Faragher v. City of Boca Raton*¹⁹ and *Burlington Industries v. Ellerth*²⁰ were fashioned in large part to

¹⁹ *Faragher v. City of Boca Raton*, 524 U.S. 775, 118 S. Ct. 2275, 1 EXC 163 (1998).

²⁰ *Burlington Indus. v. Ellerth*, 524 U.S. 742, 118 S. Ct. 2257, 1 EXC 154 (1998).

encourage employers to set up policies and procedures to promote and facilitate the reporting of sexual harassment problems and to encourage employees to use such procedures.

Some executives react to harassment by underplaying or masking the problem. It is common, for example, for executives who believe they are being discriminated against based on sex, race, or other grounds, in compensation or promotion matters to decline to label the problem as discrimination. Instead, consciously or unconsciously, they assess and address the problem in terms of basic unfairness, rather than discrimination. Sometimes, as discussed below, doing so is tactically beneficial, at least in the early stages of a problem.

3. Employer Reaction

Some employers deliberately retaliate against executives who pursue disputes against them, as unpleasant and unfair as that may seem. Some employers consciously ignore retaliatory conduct by supervisors. Often, employers fail to take affirmative steps to punish or discourage such retaliatory conduct.

Obviously, when an executive's complaint constitutes protected conduct, an employer that fails to prevent retaliation risks a claim of retaliation on top of the underlying complaint or claim. (Retaliation claims are discussed more fully below.)²¹ Indeed, retaliation claims are on the increase, and employees frequently succeed with such claims even when the underlying complaint of discrimination or harassment fails.

The obvious lesson for employers is that they should make diligent, good faith efforts to prevent retaliation and to correct any retaliation that may occur. For example, employers should educate supervisors that retaliation is unlawful in certain circumstances and is unfair in any event, especially when an employee has made a good faith, reasonable complaint. Such actions by employers not only help limit risk and avoid claims but also make good sense in terms of employee morale and satisfaction.

4. Role of Executive's Counsel

Attorneys for employees are accustomed to helping their clients deal with the stresses involved in employment disputes, including a client's feelings of rejection, betrayal, hurt, anger, and cynicism. Such stresses are multiplied when the client is still working for the employer and must deal daily with the people and institution that have caused the problems, especially when the employee perceives retaliation from those people and the institution.

Thus, the executive's counsel must be especially understanding and supportive of the client during such a dispute, while maintaining the necessary professional objectivity and distance. The counsel can help by making sure that the client anticipates what may happen once a complaint is made and that the client is prepared to deal with it. Of course, the counsel should apprise the client of relevant laws against retaliation, while also apprising the client of the limitations of such laws (e.g., their inapplicability to some types of unpleasant but legal behavior at work, the difficulty of proving retaliatory motive, and the burdens of pursuing a retaliation claim).

5. The Stay-or-Go Decision

Recognizing the risks of fighting with a current employer, some executives decide not to pursue their complaints at all, preferring to live with the problems. Sometimes, executives decide to defer addressing the problems until they get worse or until some more propitious time, or they decide to wait and gather more information that might be helpful in understanding or addressing the problems. Often, executives try

²¹ See discussion of retaliation *infra* at "Handling Disputes Involving Current Executives."

to find a way around the problems, perhaps by seeking a transfer or reassignment within the company.

If the executive decides to stay and tries to address the problems, the executive's counsel can play an important role in helping develop a plan of action. Many employees, even sophisticated executives, lack the ability to identify, evaluate, and choose the options available to them. In any event, counsel can provide an objective sounding board.

Many executives decide that the best course is simply to leave the job rather than to pursue their complaints. Of course, that course may not take into full account the possibility that the same kinds of problems, such as systemic glass-ceiling issues in many industries, may exist elsewhere as well.

Many decide to leave the job and then pursue their complaints as they leave or after leaving, perhaps in the context of negotiating a severance agreement. In addition, when a current executive asserts a claim and the parties then enter into a negotiated resolution of the claim, one of the terms of the deal may be the termination of employment. In fact, termination of employment with a severance/settlement package is occasionally a key objective of the executive when asserting a claim.

6. Problem Solving and Dispute Resolution

For the current executive who wants to try to solve problems or resolve disputes, a gradual escalation approach is best. Typically, this means that the executive, with guidance from counsel, tries to handle the matter informally. In some companies, the executive may have available company-established internal dispute resolution procedures, which may begin with informal measures, leading to mediation and arbitration steps.

Even in the absence of such company-established procedures, the executive and the employer may agree to mediation, which is especially well suited for current employees. Finally, some disputes may go to arbitration, pursuant to a postdispute agreement to arbitrate the particular dispute or pursuant to a general predispute agreement to arbitrate contained in an employment agreement or other agreement between the parties.

These problem-solving and dispute resolution methods are discussed in considerable detail elsewhere in this chapter.²²

C. Absence From Work

The current executive involved in a dispute with the employer sometimes wants and/or needs time away from work. The executive may feel the need to get away from a harassing or abusive boss for a while, may want time to reflect on events, or may need time to consult with an attorney, doctor, or other professional. Of course, the executive can always use personal, sick, or vacation days for such purposes; typically, such absences are with pay. Sometimes, when there has been a troublesome episode at work, such as a verbal assault or an instance of sexual harassment by a superior, the employer may support the executive's need for some time off.

The federal Family and Medical Leave Act (FMLA)²³ entitles eligible employees to up to 12 weeks of unpaid leave due to a serious health condition. An executive may be eligible for such leave time if, for example, a dispute at work has caused the executive such emotional distress that medical attention is required. The FMLA prohibits employers from interfering with, restraining, or denying the exercise of any right protected by the statute.²⁴ In extreme cases, the executive may need to go on disability leave.

²² See the discussion *infra* on negotiations and alternative dispute resolution in employment disputes.

²³ 29 U.S.C. §2601 et seq.

²⁴ 29 U.S.C. §2615(a).

The executive's counsel and the employer's counsel may agree on occasion that it is appropriate for the executive to stay away from work, with full pay and benefits, during negotiations over a dispute, especially when it is anticipated that the resolution may result in the termination of employment.

D. Retaliation

1. In General

For current employees more than former employees, retaliation is a major issue. Former employees can, of course, be the victims of retaliation and can assert legal claims for such retaliation.²⁵ Nonetheless, most retaliation claims arise in connection with current employees.

Retaliation claims against employers are common. For example, from 2004 through 2006, the Equal Employment Opportunity Commission received an average of about 22,000 retaliation claims each year, and more than 29 percent of all charges filed with the EEOC included retaliation claims.²⁶

It is well known that employees sometimes lose their underlying discrimination claims on summary judgment or at trial, while winning their retaliation claims. Courts and juries are generally more receptive to retaliation claims than to discrimination claims. In addition, the damages awarded for retaliation can be very substantial, including punitive damages.

2. Retaliation Laws

Many federal and state statutes prohibit retaliation against employees who engage in certain protected conduct. The protected conduct might consist of complaining of discrimination, blowing the whistle on illegal or unsafe conduct, or engaging in other conduct that the law seeks to encourage or protect (e.g., union activity or jury duty).

Antiretaliation provisions exist in the federal antidiscrimination statutes.²⁷ They also exist in many other federal statutes.²⁸ Many federal statutes protect executives and other employees who blow the whistle on

²⁵ See, e.g., *Robinson v. Shell Oil Co.*, 519 U.S. 337, 117 S. Ct. 843, 1 EXC 177 (1997).

²⁶ Equal Employment Opportunity Commission, Charge Statistics: FY 1997 Through FY 2006, at <http://www.eeoc.gov/stats/charges.html>.

²⁷ E.g., Americans with Disabilities Act (ADA), 42 U.S.C. §12203 ; Age Discrimination in Employment Act (ADEA), 29 U.S.C. §623 ; Civil Rights Act of 1964 (Title VII), 42 U.S.C. §2000e-3 ; Vocational Rehabilitation Act, 29 U.S.C. §§793 , 794.

²⁸ E.g., Employee Polygraph Protection Act, 29 U.S.C. §2002 ; ERISA, 29 U.S.C. §1140 ; Fair Labor Standards Act (FLSA), 29 U.S.C. §§215(a) , 216(b) ; FMLA, 29 U.S.C. §2614(a) ; Longshoremen's and Harbor Workers' Compensation Act, 33 U.S.C. §948(a) ; Migrant and Seasonal Agricultural Worker Protection Act, 29 U.S.C. §1855 ; 29 U.S.C. §National Labor Relations Act (NLRA), 158 ; Occupational Safety and Health Act (OSHA), 29 U.S.C. §660(c) ; Railroad Employers Act, 45 U.S.C. §60. Additional protections against retaliation by employers against employees exist under the Federal False Claims Act, 31 U.S.C. §3730(h).

public health and safety issues.²⁹ Other federal statutes protect executives and other employees who blow the whistle in other contexts.³⁰

Virtually every state has an antidiscrimination statute, and those statutes invariably have antiretaliation provisions. About 40 states have enacted whistle-blower protection statutes, although these range from very narrow³¹ to very broad.³² Some states recognize public policy grounds for wrongful discharge cases, which may be based on the employee's engaging in conduct that public policy recognizes should be protected.

3. Retaliation Under Title VII

Undoubtedly, the most common retaliation claims are those that arise under Title VII of the Civil Rights Act of 1964, as amended. Section 704(a) of Title VII³³ (and parallel provisions of other employment statutes) makes it unlawful to retaliate against an individual (1) "because he has made a charge, testified,

²⁹ See, e.g., Asbestos School Hazard Detection and Control Act, 20 U.S.C. §3608 ; Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), 42 U.S.C. §9610 ; Clean Air Act, 42 U.S.C. §§7401 , 7622; Energy Reorganization Act (Atomic Energy Act), 42 U.S.C. §5851 ; Federal Mine Safety and Health Act, 30 U.S.C. §§815 , 820(b); Federal Railroad Safety Act, 45 U.S.C. §441(a) , (b)(1); Federal Water Pollution Control Act, 33 U.S.C. §1367 ; International Safe Container Act, 46 U.S.C. §1506 ; OSHA, 29 U.S.C. §660(c) ; Safe Drinking Water Act, 42 U.S.C. §300j-9(i) ; Solid Waste Disposal Act, 42 U.S.C. §6971 ; Surface Mining Control and Reclamation Act, 30 U.S.C. §§1201 , 1293; Surface Transportation Assistance Act, 49 U.S.C. §2305 ; Toxic Substances Control Act, 15 U.S.C. §2622.

³⁰ See, e.g., Civil Rights of Institutionalized Persons Act, 42 U.S.C. §1997(d) ; Conspiracy to Obstruct Justice Act, 42 U.S.C. §1985(2) ; Consumer Credit Protection Act, 15 U.S.C. §1674(a) ; Department of Defense Authorization Act, 10 U.S.C. §2409 ; Federal Deposit Insurance Act, 12 U.S.C. §1831(j) ; Federal Property and Administrative Services Act, 41 U.S.C. §251 ; Jury Duty Act, 28 U.S.C. §1875 ; Major Fraud Act, 18 U.S.C. §1031(g) ; Vietnam Era Veterans' Readjustment Assistance Act (VEVRAA), 38 U.S.C. §§2021(b) , 2024(c).

³¹ See, e.g., N.Y. LABOR LAW §740 (protecting only those private sector employees who blow the whistle on employer misconduct that *both* (i) violates a law, rule, or regulation and (ii) creates and presents a substantial and specific danger to public health or safety); *Bordell v. General Elec. Co.*, 622 N.Y.S.2d 1001, 1 EXC 402 (App. Div. 3d Dep't 1995) (nuclear reactor employee's reasonable belief there was radiation leak insufficient because §740 requires "actual" violation of law, rule, or regulation, not mere supposition that violation has occurred), *aff'd*, 644 N.Y.S.2d 912 (1996); *Rotwein v. Sunharbor Manor Residential Health Care Facility*, 695 N.Y.S.2d 477, 1 EXC 410 (N.Y. Sup. Ct. 1999) (opposing Medicare billing improprieties did not involve immediate threat to public health and safety).

³² See, e.g., MICH. COMP. LAWS ANN. §17.428 (protecting employees who report or are "about to report. . . a violation or a suspected violation of a law . . . to a public body"); *Dudewicz v. Norris Schmid, Inc.*, 480 N.W.2d 612, 1 EXC 396 (Mich. Ct. App. 1991) (applying Michigan whistle-blower statute even though the violation of law did not pose a risk to the public at large, holding that auto dealership employee had the right to press criminal charges against manager who assaulted plaintiff in dispute over performing work for customer with warranty), *aff'd in part and rev'd in part by*, 443 Mich. 68 (1993) (court affirmed with respect to the whistleblower claim).

³³ 42 U.S.C. §2000-e3(a).

assisted, or participated in any manner in an investigation, proceeding, or hearing under this [title]" or (2) "because he has opposed any practice made an unlawful employment practice by this [title]." The former section is known as the "participation" clause; the latter is known as the "opposition" clause.

To establish a claim for unlawful retaliation, the plaintiff must prove three things: (1) that the employee engaged in protected opposition to discrimination, (2) that a reasonable employee would have found the challenged action materially adverse, and (3) that a causal connection existed between the protected activity and the materially adverse action.³⁴

Generally, participation clause protection is narrower (covering fewer activities) but deeper (more categorically protected), whereas opposition clause protection is broader but shallower. The participation clause protects any person who has participated in any manner in Title VII proceedings (or the necessary precursors to such proceedings).³⁵ Generally, under the participation clause, the plaintiff is protected regardless of whether the complaint of discrimination was meritorious or whether the plaintiff had a reasonable, good faith belief that the employer discriminated.³⁶

The opposition clause is more narrowly applied. Generally, the plaintiff's statements or conduct must have been objectively reasonable and in good faith.³⁷ Accordingly, an employee who makes a reasonable, good faith complaint about discrimination is protected against retaliation, even if the discrimination complaint itself lacks merit.³⁸

The employee may not be protected if the complaint is too vague or indefinite or is not about discrimination.³⁹ On the other hand, the employee might forfeit protection by going too far in exercising the right to oppose, such as stealing company documents, disclosing confidential information, or acting in an insubordinate manner.⁴⁰

³⁴ *Burlington N. & Santa Fe Ry. Co. v. White*, 125 S. Ct. 2405, 2415, 5 EXC 18 (2006).

³⁵ *Glover v. South Carolina Law Enforcement Div.*, 170 F.3d 411, 1 EXC 224 (4th Cir. 1999) ("those who testify in Title VII proceedings are endowed with 'exceptionally broad protection.' [I]t is followed by the phrase 'in any manner'—a clear signal that the provision is meant to sweep broadly"); *Merritt v. Dillard Paper Co.*, 120 F.3d 1181, 1 EXC 302 (11th Cir. 1997) (the plaintiff was discharged after admitting in deposition that he had engaged in sexually harassing activities; the discharge was unlawful because it was based on the fact and content of his testimony, rather than the harassing conduct); *McKenzie v. Illinois Dep't of Transp.*, 92 F.3d 47, 1 EXC 426 (7th Cir. 1996) (the employer threatened employees not to provide affidavits that would assist plaintiff in her lawsuit; if the employer had carried out its threat, the employees would have had a claim for retaliation for participating in plaintiff's EEO lawsuit).

³⁶ See *Glover*, 170 F.3d at 411. *But see* *Learned v. City of Bellevue*, 860 F.2d 928, 1 EXC 275 (9th Cir. 1988).

³⁷ See *Sarno v. Douglas Elliman-Gibbons & Ives Inc.*, 183 F.3d 155, 1 EXC 209 (2d Cir. 1999); *Kubicko v. Ogden Logistics Serv.*, 181 F.3d 544, 1 EXC 229 (4th Cir. 1999).

³⁸ See *Bigge v. Albertsons Inc.*, 894 F.2d 1497, 1 EXC 298 (11th Cir. 1990).

³⁹ See *Wolf v. Coca-Cola Co.*, 200 F.3d 1337, 1 EXC 306 (11th Cir. 2000); *Galdieri-Ambrosini v. National Realty & Dev. Corp.*, 136 F.3d 276, 1 EXC 198 (2d Cir. 1998).

⁴⁰ See *Laughlin v. Metropolitan Wash. Airport Auth.*, 149 F.3d 253, 1 EXC 230 (4th Cir. 1998); *Douglas v. DynMcDeremott Petroleum Operations Co.*, 144 F.3d 364, 1 EXC 241 (5th Cir. 1998); *Nelson v. Pima*, 83 F.3d 1975, 1 EXC 278 (9th Cir. 1996).

In 2006, the Supreme Court in *Burlington Northern & Santa Fe Railway Co. v. White* resolved a circuit split concerning the proper burden of proof in retaliation claims under Title VII.⁴¹ In *White*, the court concluded that the plain language of Title VII demonstrates a congressional intent that protection against retaliation be broader in scope than protection against discrimination.⁴² In addition, other courts have also found that an employer's perception, even if mistaken, that an employee engaged in some sort of protected activity is sufficient to support a retaliation claim, assuming other required elements are also met.⁴³

Under the new standard articulated in *White*, the employee does not need to have suffered a substantial "adverse employment action" in order to bring a valid retaliation claim. Instead, the employee needs to "show that a reasonable employee would have found the challenged action materially adverse, which in this context means it well might have dissuaded a reasonable worker from making or supporting a charge of discrimination." Beyond the prima facie burden, the courts examine whether the targeted conduct is unlawful by assessing the individual facts and circumstances of each employment relationship and each workplace. To be actionable, the conduct must be "material" and not "petty slights or minor annoyances that often take place at work that all employees experience."⁴⁴ The Supreme Court in *White* left it to the lower courts to determine, on a case-by-case basis, the parameters of unlawful actions by employers.⁴⁵

To establish a retaliation claim, employees must establish not only protected conduct and an adverse action but also a causal nexus between the two. Obviously, this means at a minimum that the employer's relevant decision makers must have known about the protected conduct. Mere proximity in time may be enough to create a strong inference of causation. On the other hand, the longer the time between the

⁴¹ See *Burlington N. & Santa Fe Ry. Co. v. White*, 126 S. Ct. 2405, 5 EXC 18 (2006).

⁴² *Id.*

⁴³ See, e.g., *Fogelman v. Mercy Hosp., Inc.*, 283 F.3d 561, 571 (3d Cir. 2002) (stating that because ADA and ADEA "focus on the employer's subjective reasons for taking adverse action against an employee, . . . it matters not whether the reasons behind the employer's discriminatory animus are actually correct as a factual matter"); *Saffels v. Rice*, 40 F.3d 1546, 1549-50 (8th Cir. 1994) (concluding that language of and intent behind Fair Labor Standards Act "protects employees who are discharged based on their employer's mistaken belief that they reported violations or otherwise engaged in protected activity"); *Grosso v. City Univ.*, 2005 WL 627644, at *3-*4 (S.D.N.Y. Mar. 16, 2005) (finding "perception theory" valid basis for Title VII retaliation claim).

⁴⁴ *White*, 126 S. Ct. at 2415 (internal quotations and citations omitted).

⁴⁵ In light of *White*, courts have revisited what constitutes a "materially adverse action": *Burks v. Wis. Dep't of Transp.*, 464 F.3d 744, 5 EXC 19 (7th Cir. 2006) (negative performance reviews and termination); *Phelan v. Cook County*, 463 F.3d 773 (7th Cir. 2006) (four month termination, despite subsequent reinstatement and award of back pay); *Joseph v. Leavitt*, 465 F.3d 87 (2d Cir. 2006) (relief from job duties and a substantial reduction in duties and responsibilities); *Taylor v. Roche*, 196 Fed. Appx. 799 (11th Cir. 2006) (repeated refusal to transfer employee to night shift); *Cassimy v. Bd. of Educ. of Rockford Pub. Schs., Dist. # 205*, 461 F.3d 932, 938 (7th Cir. 2006) (reclassification of administrator to teacher); *Mickelson v. New York Life Ins. Co.*, 460 F.3d 1304, 1316-17 (10th Cir. 2006) (denial of employee's request to return to work part-time); *Randolph v. Ohio Dep't of Youth Servs.*, 453 F.3d 724, 736-37 (6th Cir. 2006) (placement on administrative leave and subsequent termination, despite eventual reinstatement with 75 percent back pay); *Kessler v. Westchester County Dep't of Soc. Servs.*, 461 F.3d 199, 207-08 (2d Cir. 2006) (transfer); *Pryor v. Wolfe*, 2006 WL 2460778, at *2 (5th Cir. Aug. 22, 2006) (withholding of employee's paycheck for hours worked after he filed an EEOC complaint); *Minor v. Centocor, Inc.*, 457 F.3d 632, 634 (7th Cir. 2006) (assignment of extra work); *Jordan v. City of Cleveland*, 464 F.3d 584 (6th Cir. July 6, 2006) (unfair transfers and significant loss of job responsibility); *Thomas v. iStar Fin., Inc.*, 438 F. Supp. 2d 348, 365 (S.D.N.Y. 2006) (providing negative references or refusing to give positive references).

protected conduct and the adverse action, generally the weaker the inference. Even so, a delay may be explained away, for example, when it takes a while for a superior to have an opportunity to retaliate, such as by giving a poor annual evaluation or a small annual bonus.

III. Negotiations and ADR in Employment Disputes

The opportunities are legion for problems and disputes to arise out of the employment relationship—during and after the period of employment and involving nonlegal as well as legal issues. Counsel for executives should, of course, be familiar with the legal issues that may arise and with the traditional legal procedures for addressing such legal issues. But familiarity with such legal matters is not enough.

Counsel for executives should also be familiar with tactics, strategies, and methods for solving legal and nonlegal problems and for resolving disputes that do not necessarily depend on the assertion of legal rights and that do not necessarily employ formal legal procedures. This section presents negotiation approaches and dispute resolution procedures for the problems and disputes often encountered by executives and their counsel.

A. Alternative Dispute Resolution: An Overview

1. Primary Problem Solving

Generally, executives and their counsel should seriously consider using so-called alternative dispute resolution (ADR) mechanisms. Broadly speaking, ADR encompasses a wide spectrum of approaches for resolving disputes other than through judicial proceedings. ADR might be more accurately described as *primary* problem solving or dispute resolution, inasmuch as it should be considered before litigation, not merely as an alternative to litigation.

2. The Litigation Alternative

The vast majority of employment-related disputes do not need or warrant litigation; litigation can be simply too expensive, slow, inefficient, and inflexible for many such disputes. Nonetheless, litigation is a necessary alternative (perhaps, a "last resort") when other mechanisms to avoid or resolve a dispute have failed. The availability of litigation, of course, is sometimes essential to spur parties to engage seriously in ADR procedures.

3. An Escalation Approach

A gradual escalation-of-confrontation approach can be especially useful in employment disputes. The executive's attorney should first try to resolve a problem through an approach that is the least confrontational but that has a reasonable prospect of success (e.g., direct negotiations between parties). If this does not work, the attorney should next try more a confrontational or adversarial approach (e.g., internal corporate procedures, then external or formal mediation, then nonbinding arbitration). This approach is discussed in "An Escalation Approach," below.

4. Internal Dispute Resolution Procedures

Over the past two decades, more and more companies have instituted internal dispute resolution procedures. Unless the executive perceives that the company's procedures are unfair or futile or that use of the process would be prejudicial, the executive should seriously consider using such procedures. Even if this procedure does not work for the executive, he or she will probably learn in the process about the strengths and weaknesses of each party's positions. Also, for similar reasons, many courts have court-

annexed mediation programs.

5. External ADR

Once an executive decides to take a dispute "outside" the company, various alternatives are available. The executive and the employer may agree to employ mediation with a paid, private mediator and/or to submit the dispute to arbitration. In employment discrimination cases, of course, the executive can go to the EEOC or to a state or local human rights agency. Such agencies are using ADR techniques, especially mediation, more and more to try to reduce their backlog of charges.

6. Mediation

Mediation is an increasingly popular ADR procedure for employment disputes. Instead of direct negotiations between the parties or their attorneys, mediation involves negotiation facilitated by a neutral third party. The key benefit of mediation is that it is voluntary and nonbinding. The parties can design the process to suit the dispute, can choose the mediator, and can retain control over whether and how to settle. Done right, mediation can resolve disputes relatively quickly and amicably that could not be settled through direct negotiations.

7. Arbitration

Arbitration raises considerations that are altogether different from those arising from mediation. Arbitration is an adversarial proceeding in which a neutral third party, selected by parties, decides the dispute instead of a judge. Binding arbitration entails surrendering the authority to resolve the dispute to the neutral third party.

8. Hybrids

Characteristic of the flexibility of ADR programs, various "hybrids" of mediation and arbitration have been tried with some success.

B. An Escalation Approach

The best strategy for executives and their counsel to use in many employment disputes is a gradual escalation approach. This approach is especially well suited for disputes involving executives who are still employed. In that context, the executive and the employer have an existing relationship that may be maintained and even enhanced if handled properly or that may be harmed or even ruined if handled improperly.

Under an escalation approach, an executive initially tries to solve problems and resolve disputes without undue confrontation with management. Rather than threatening to file charges or start a lawsuit, the executive should first try to engage in a constructive dialogue with appropriate company representatives to identify the problem and try to resolve it.

If the executive has counsel, the counsel often will stay in the background and the executive will not even mention the counsel. This can facilitate direct discussions between the executive and the company's representatives. Once counsel appears on the scene, the dynamics change. Often, the company's counsel then appears on the scene and the discussion escalates to a level that is less conducive to an amicable resolution.

With the use of this approach, the executive and the employer might resolve the dispute without undue harm to the relationship. If it works, that is good for everyone. If it does not work, the executive can

always escalate. For example, the executive might next assert that the employer's conduct is not only unfair but also is illegal and that the executive is considering asserting a legal claim. This step obviously might aggravate the employment relationship, particularly between the executive and any persons charged with illegal conduct; and it risks retaliation. On the other hand, this step might be necessary to get the employer's attention, to convey the seriousness of the executive's position, to call attention to the employer's risks, or to provide legal protection against retaliation.

At this stage, the executive is more likely to reveal the existence of counsel. Even then, however, the executive may be better off trying to keep counsel in the background. This will allow the affected parties to try to resolve the dispute without greater harm to the relationship than may arise if counsel for the parties get involved directly. Of course, in such situations, it is likely that counsel will be in the background on both sides, but the opportunity for direct dealing between the parties may lessen the tensions. On the other hand, in some situations, counsel can bring objectivity and perspective to both sides and thereby facilitate dispute resolution.

The executive's counsel should carefully consider the best tactics applicable to the situation. The relative roles of the executive and the counsel during the early stages should be based on a careful assessment of various factors, including the ability and willingness of the executive to handle the discussions without counsel present and the approach that is most likely to be effective.

It warrants repeating, however, that if a less confrontational step is tried and fails, the executive can then escalate to a more confrontational approach. It is difficult, however, to go in the other direction, to de-escalate from a confrontational approach to a less confrontational approach. Thus, it generally makes sense to begin at the lowest level of confrontation that has a realistic chance of success, unless the possible cost in time or energy outweighs the possible benefit or unless a statute of limitations is a concern.

C. Internal Dispute Resolution Procedures

Many companies have instituted internal dispute resolution procedures. These may range from informal policies, such as an open-door policy, to formal final and binding arbitration. In between, the dispute resolution procedures might include an ombudsperson, peer review, early neutral evaluation, mediation, and other measures to identify and solve problems.

Companies that set up such procedures generally find that they serve two separate but compatible objectives: First, from a human resources perspective, they help build morale, avoid friction, reduce turnover, and promote productivity. Second, from a legal and financial perspective, they tend to reduce the costs and risks of adversarial proceedings. As discussed below, they may also provide appropriate opportunities to resolve disputes from the perspective of executives.

Company procedures typically include mediation using external mediators. The sponsoring company usually pays all or most of the cost of the mediation. Some companies provide an allowance, perhaps \$2,500, for the executive to retain counsel for the mediation.

Many company procedures have arbitration as the last stage of the process. Some companies attempt to impose mandatory predispute binding arbitration on their executives as a condition of initial or continued employment; employees' counsel oppose such requirements for various reasons, including the fact that the "agreement" to arbitrate is seldom truly knowing and voluntary. Many companies, perhaps recognizing the legal, policy, and personnel problems with these mandatory arbitration requirements, offer arbitration that is voluntary at that point, that is not binding on any of the parties, or that is binding only on the employer (allowing the executive to retain rights to litigate). In any event, under appropriate circumstances, arbitration might be appropriate for an executive's claim, given that arbitration is usually faster and less expensive than litigation. This is especially true for nondiscrimination claims, such as those involving compensation or contract disputes.

Whatever the merits of arbitration for employment disputes, this approach is generally well suited for disputes with current executives, especially if the alternative is litigation. Arbitration is used routinely for disputes that arise under collective bargaining agreements and has proved quite successful in that context. Of course, the nonunion context raises quite different issues, as the courts have generally

recognized. Nonetheless, for current executives, the opportunity for a relatively quick and inexpensive resolution of a dispute has obvious advantages, including allowing the parties to move on with the employment relationship.

Executives and their counsel should seriously consider using a company's internal dispute resolution procedures but should be appropriately skeptical about the process: it may be procedurally or substantively unfair; it might be used to cover up problems or to build the company's defense; or it might lead to reprisals against the executive. Thus, counsel and the executive should try to ascertain the credibility and fairness of the company's process. Counsel should ask the executive what the experience of other employees has been with the process; the executive might ask other employees what they know from personal experience or what they have heard about the process.

After such an evaluation, counsel and the executive must decide whether and how to use the company's process. Generally, unless it is clear that the process is tainted, is a waste of time, or may lead to repercussions, the executive who is still working for the company should use the process. It may lead to a favorable resolution without further expense, delay, or confrontation. Even if it does not lead to a favorable resolution, the executive may learn a good deal during the process about the strengths and weaknesses of both parties' positions. Even in defeat, the executive might be satisfied that the process was fair and that the company was right or that further pursuit of the dispute is otherwise not warranted.

D. Mediation of Employment Disputes

1. What Disputes to Mediate

An attorney representing executives—or employers—should consciously consider mediation in virtually every significant employment dispute that cannot be resolved through direct negotiations.⁴⁶

Familiar surveys have shown consistently that a very high percentage of civil lawsuits settle before judgment, typically more than 90 percent. And countless disputes settle before they ever mature into lawsuits. Therefore, it is highly likely that any particular dispute will settle at some point; the question usually is, when? Mediation presents the opportunity to ascertain whether such disputes can be settled earlier in the process than may otherwise be the case.

The success rate for mediation depends on numerous variables, such as the ability and techniques of the mediator and the manner in which the mediation was initiated. Empirical evidence suggests that the success rate is much higher when the parties initiate and pay for the mediation compared with when parties are pressured into forum-annexed mediation by a judge or someone else. Reports indicate that court-annexed and agency-annexed mediation programs have success rates in the 50 percent to 60 percent range, whereas private mediations succeed 80 to 90 percent of the time. (For these purposes, "success" is defined as a settlement satisfactory to the parties.) Sometimes, even when a mediation session fails to result in a settlement at that time, the session may lay the groundwork for a subsequent settlement.

The benefits of mediation include the following:

- (1) avoids the expense and delay of litigation;
- (2) engages the parties in creative problem solving;
- (3) may lead the parties to adopt solutions that a judge could not or would not direct;
- (4) helps maintain or repair relationships between the parties;
- (5) provides the parties a "day in court" and an opportunity to vent;

⁴⁶ Although the following discussion of mediation may apply to employees in general, it is particularly applicable with respect to executives because of the parties' concerns about avoiding bad publicity and because relatively large sums of money and complex benefit arrangements may be involved.

- (6) allows the parties to learn from their mistakes and take corrective measures (e.g., employers learning of poor management practices or errant managers);
- (7) keeps the dispute and its resolution confidential; and
- (8) avoids public disclosure of private or sensitive matters.

Many employment disputes, including discrimination claims, lend themselves to mediation. The following types of situations are especially well suited for mediation:

- (1) *Where the Executive Still Works for the Employer:* The parties may be able to maintain or reestablish a good working relationship, which is obviously hard to do when the parties are engaged in adversarial litigation.
- (2) *When Private or Sensitive Matters Are Involved, Such as Sexual Harassment Claims:* The parties, especially the employer and the alleged harasser, often prefer to discuss and resolve such matters in the confidential context of a mediation, without the embarrassment or discomfort of public proceedings.
- (3) *When "Reasonable Accommodations" Are Sought Under the Americans with Disabilities Act:* The executive and employer, who are most familiar with the executive's condition and abilities and with the functions and nature of the job, can try constructively to find effective ways for the executive to do the essential functions of the job.

Whatever the nature of the dispute, the parties and their attorneys must have a good faith interest in trying to resolve the dispute on reasonable terms. If either party lacks such good faith going into the mediation, the chances of resolution are hindered.

Some attorneys are reluctant to suggest mediation because they fear that doing so will suggest weakness: This is an overblown concern. Most experienced litigators recognize that a very high percentage of cases settle and that litigation is a costly and risky process for all parties. Accordingly, an executive's attorney should not be afraid to consider settlement discussions, including possible mediation.

Mediation does have some drawbacks. When it does not succeed, the parties may have incurred some expense and delay in the process, although these are generally relatively minor in the context of a litigated dispute. Moreover, when a party (or party's attorney) does not engage in mediation for the right reasons (i.e., with the good faith intention to try to reach a fair and reasonable resolution), then the other party may feel—with some justification—used and abused, especially if it appears that the other party was engaging in mediation for devious reasons (e.g., to stall proceedings or to get some "free discovery"). Fortunately, such conduct is uncommon, especially as attorneys and their clients learn the advantages of giving mediation a good-faith try.

For both executives' and employers' attorneys, a common problem is convincing the other side to try mediation. This is especially problematic when the opposing attorney is unfamiliar with the process or is suspicious of the motives of the person suggesting it. A good way to address the former problem is to refer the opposing attorney to other attorneys who have experience with the process; almost invariably, this works to convince the attorney that mediation is an effective device for employment disputes. The latter problem requires convincing the other attorney that good faith is involved and that mediation will not be a waste of time or money. In any event, most attorneys, once they understand the process, realize that they have little to lose by trying it.

Concerns of the type mentioned above are reduced when mediation is required or "suggested" by a court or agency or by a company's internal dispute resolution procedure or in a contract.

2. When to Mediate

As a general principle, the best time to mediate is "sooner rather than later." Of course, there are exceptions.

The primary tension here is between cost and information, although other factors can matter, too (e.g., determination of a key legal issue). Given that most cases do settle at some point, money spent on litigating (e.g., attorneys' fees, deposition costs, and expert fees) can make it harder to settle later rather than sooner. Money spent by the employer on litigating could be used to supplement the settlement "pot." Money spent by the executive (or executive's counsel) on litigating can push up the amount needed to settle the case; this is true whether the executive's attorney is working under an hourly, contingency, or other arrangement. Often, the primary beneficiaries of litigation are the lawyers, particularly defense attorneys who are paid on an hourly basis.

Some employment attorneys assert that mediation is inappropriate until the eve of trial because the parties are not serious about settlement until they are "on the courthouse steps." Although this is certainly true sometimes, empirical evidence strongly suggests that, at least in employment cases, that view is unfounded. In fact, given some modicum of good faith and reasonableness, the vast majority of employment cases that go to mediation—generally long before trial—do settle.

Some employment attorneys assert that mediation is inappropriate until after substantial discovery has been completed. Plaintiffs' attorneys say that they need certain information before they can properly evaluate the settlement value of the case. For example, in a discrimination case, the attorney may need comparative information about other executives.

Defense attorneys say that they need to take the plaintiff's deposition before considering mediation; and plaintiffs' attorneys sometimes say they first need one or two key depositions. Generally, these views are unwarranted. Full-blown discovery is not always needed to evaluate the case. In any event, parties can and often do condition participation in mediation on the other side supplying essential information beforehand. Thus, the executive's attorney might agree to mediate only after the employer has provided certain information, such as the executive's complete personnel file, designated correspondence or other documents, and files and information about certain other executives.

Moreover, during mediation sessions, as the need for certain information becomes evident, the parties can arrange for the information to be supplied; it is not unusual to adjourn a mediation session pending the disclosure of such information.

Another factor favoring early mediation is that, during litigation, parties' positions sometimes harden, particularly if they believe the other side has abused them or the process during the litigation. For example, a plaintiff who has endured a brutal deposition may feel that he or she wants to reciprocate by causing pain to the other side. Or an executive of the defendant employer who has been accused of serious discriminatory, harassing, or other heinous behavior may seek vindication. Early mediation can mitigate such developments.

3. The Mediation Forum

Many courts have court-annexed mediation programs under which litigants can be required to participate by court rules or by order of a judge or magistrate. The EEOC and many fair employment practice agencies have mediation programs under which the parties might be asked to participate in mediation. These programs have several advantages: they cost the parties nothing (except of course attorneys' fees), they present the occasion for mediation without either party having to ask for it, and the mediators are sometimes knowledgeable about employment law.

On the other hand, the caliber of the mediators in such programs varies widely. Most court-annexed programs (and many agency programs) rely on volunteer attorneys to serve as mediators. Although these volunteers are generally able and are experienced litigators and have had some mediation training, few are expert mediators; as discussed below, the mediator is the key to a successful process.

Many company-established dispute resolution procedures include mediation as an option or as a "mandatory" step in the process. Fortunately, under such programs, the attorneys generally have the opportunity to participate in selecting the mediator and the company pays most or all of the cost. In fact, under some programs, the company provides an allowance of a certain amount that the employee can use for attorneys' fees.

Professional, independent mediators are often used in mediation. Most areas of the country now have access to such mediators. JAMS has offices in many cities, and most cities have firms (such as ADR Associates in New York City and Washington) and individuals who specialize in mediating employment disputes; the AAA and the CPR Institute for Dispute Resolution also provide mediators or lists of mediators. Many professional mediators travel readily to the location of the parties. Although professional mediators are often the best, they are also the most expensive. In New York City, such mediators typically charge \$300 to \$600 per hour. If the dispute involves substantial claims, such private mediation is generally the best approach.

4. The Mediator

An effective mediator is essential. Indeed, a good mediator is the single most important factor in successful mediations. Not everyone can be a good mediator; retired judges do not necessarily make good mediators, although some are. The most important characteristics for a mediator are good interpersonal and listening skills, creative problem-solving skills, and credibility with the parties. Substantive knowledge of the law is very helpful but is not as essential as the mediator's skills.

Mediators' styles vary. The most common approaches are typically referred to as "facilitative" and "evaluative." Under the facilitative approach, the mediator serves as a facilitator for the exchange of views and positions between the parties. This may include, for example, encouraging parties to "vent" their feelings and express their needs and wants. It may also include helping each side understand better the points of views of the other side and helping the parties find mutually beneficial solutions. Under the evaluative approach, the mediator analyzes the parties' legal, evidentiary, and factual positions and explains to the parties and their attorneys the strengths and weaknesses of each party's case. Although some mediators tend to use more of one approach than the other, most successful mediators use some of both. Typically, such a mediator will spend considerable time at the beginning of the mediation on the facilitative approach and then gradually become more evaluative as the mediation unfolds, with some movement back-and-forth between approaches.

In selecting a mediator, one should ask the prospective mediator about his or her experience with cases of the type involved and ask for references. A good source of information is other employment attorneys. For employees' attorneys, calls to colleagues in the National Employment Lawyers Association can be especially helpful.

5. Premediation Discussion and Preparation

When the mediation is not pursuant to a court or agency program, the attorneys for the parties will need to discuss and agree on who to use as the mediator, where the mediation will take place, who will attend the mediation from each side, and who will pay for the mediator.

Having the right people attend from each side can be essential to the success of the process. Obviously, the executive must attend. The executive's attorney may also recommend that the client bring his or her spouse or "significant other." Not only can that person provide valuable support at the mediation, he or she can be involved in the decision-making process. This reduces the risk that, after an agreement is reached during the mediation, the spouse or significant other will disagree with the outcome and either pressure the executive to change his or her position or criticize the executive for the outcome.

In the alternative, a member of the executive's family or a close friend may be helpful to the executive during the process. Who should attend for the employer is discussed below.

Generally, the starting point for discussion on who pays for the mediator is an equal sharing. The executive's attorney often can and should try to get the employer to pay more than half of the cost, up to 75 percent to 90 percent. This is often possible, especially when the employee cannot afford the cost and the employer is genuinely interested in trying to settle the case. The employee's attorney usually does not try to get the employer to pay 100 percent of the cost, on the theory that it is appropriate and desirable for

the executive to invest financially in the process. In any event, whatever the cost-sharing arrangements are at the outset, the executive's attorney often can succeed, if the case settles during mediation, in shifting all of the cost to the employer as part of the settlement.

Attorneys should prepare themselves and their clients thoroughly for mediation. Although the commitment of time and energy need not approach that of preparing for trial, the parties should not "wing it." Appropriate preparation will, of course, help toward a satisfactory outcome.

Preparation includes educating the client about the process—explaining how mediation works, what the mediator's role is, how the process will unfold, how the attorneys will conduct themselves, how the parties are likely to conduct themselves, how long the process might take, and so forth.

The attorney and client should also discuss in detail the potential remedies achievable through litigation and through negotiation. With the client's assistance, the attorney should prepare a "damages chart" addressing each element of recoverable damages. In appropriate situations, an actuary or economist may be retained to prepare a comprehensive report on damages. Such a damages chart or report will help the attorney and client understand and evaluate their negotiating position. Moreover, it can be shared with the mediator and with the other side before or during the mediation, serving as a checklist for discussion purposes.

The attorney and client should discuss their goals for the mediation, including the client's wants, needs, and interests. They should talk openly about what the client hopes to achieve and should think creatively about possible solutions and remedies achievable through negotiation. They should also discuss the alternatives to a negotiated resolution, including the costs, time, and risks involved in litigation. Although the attorney and client should discuss general ranges of financial recovery, they should not fix on any "bottom line" positions or predetermined lines of approach. Flexibility is important. Parties must be free to respond to information, positions, and arguments that arise during the mediation.

The executive's attorney should seriously consider having the executive personally make a substantive opening statement. This is the client's opportunity to tell his or her "story" directly to the other side. Having the client make this opening statement gets the client actively involved in the process, both before and during the mediation session. In addition, often, a sincere, credible, and strong opening statement can have a substantial impact on the other side's view of the employee, the employee's case, and/or the appropriateness of remedial measures. Thus, well before the mediation, the executive's attorney should discuss with the executive the outlines of what he or she might say and then ask the executive to prepare a proposed statement (whether in outline form or in text). Finally, shortly before the mediation, the attorney and the executive should review what the executive is planning to say.

Generally, the statement should include, from the client's perspective, what happened, the effect of the events on the client (and maybe the client's family), and why the client deserves remedial action. The statement should not directly address legal issues and generally should not include specific demands or terms. The length of the statement depends on the circumstances, but 15 to 20 minutes is usually appropriate. Although the statement should be in the client's own words, the attorney, after reviewing the statement, should suggest additions, deletions, and changes to make the statement more effective.

6. Premediation Conference

Typically, the mediator will conduct a premediation telephone conference with the attorneys. In that conference, the mediator will outline the procedure and answer any questions the attorneys may have. An important aspect of this conference, from the perspective of the executive's attorney especially, is to ensure that the employer sends someone to the mediation who has sufficient authority to settle the case. Otherwise, the process can become blocked or stalled if the company representative lacks sufficient authority. It is a poor practice for the representative present to have to call someone who has not been part of the process to explain why the company should pay more money or make some other arrangement.

Also during that conference, the mediator will discuss the parties' premediation written submissions. The mediator can understand the case better and more quickly when the parties have supplied such submissions. Given that the parties and their attorneys will have ample opportunity during the mediation

to make whatever points they want to make to the mediator and to address any issues that arise, the submissions need not be comprehensive; they should be as short and simple as possible.

The object is merely to acquaint the mediator with the background of the dispute, the status of any litigation and settlement discussions, key factual issues and relevant documents, and important legal issues. The mediator will ask the attorneys whether they want to share their submissions with the other side. Sometimes, the attorneys will submit some materials that are shared and others that are not.

The conference will also include a discussion of the mediation agreement that the parties and their attorneys will be asked to sign before or at the mediation. This agreement will set forth certain key aspects of the mediation, including the fact that the parties will keep the contents of the mediation completely confidential and that no one can use mediation communications, including factual positions and settlement offers, in any subsequent proceedings.

Finally, in the context of private (e.g., noncourt or agency) mediation, the mediator and the parties will discuss the mediator's fees.

7. The Mediation

For most mediations of employment disputes, the parties and their counsel should plan on a full day for the session. Virtually all such mediations take at least several hours. Indeed, it is advisable not to make any plans for the evening of a mediation because many run into the evening hours.

The mediator invariably opens the session with preliminary remarks about the process and invites questions from the participants. The participants are urged to listen carefully and patiently to the other side's statements, with an open mind. The parties are also reminded of the confidentiality of the process. The parties are then invited to make opening statements, with the executive usually going first. As discussed earlier, some executive's attorneys have their client make a substantive opening statement. Most defense attorneys prefer to make the statements for their side, rather than having their clients speak. (In fact, many defense attorneys apparently instruct their clients not to speak at all during joint sessions.) After the opening statements, the mediator may ask the parties whether they have any additional comments or have any questions, and the mediator may ask some questions to clarify certain issues.

At that point, the mediator usually begins caucuses with the parties and their counsel in separate rooms, typically beginning with the executive's side. From that point on, most of the rest of the mediation probably will consist of separate caucuses, with the mediator shuttling back and forth between the caucus rooms. The mediator may meet separately with just the attorney for one party or the attorneys for all parties. Deciding with whom to meet and in what order is part of the mediator's art. Usually, the separate groups do not get together again until the end of the mediation, perhaps to shake hands over a settlement and to work out the language of a written agreement.

If the parties reach an impasse in negotiations, the mediator may suggest a "mediator's proposal." Essentially, this is a proposal that the mediator makes to the parties on a "take or leave it" basis to try to bridge the gap. The mediator tells each party to say "yes" or "no" to the proposal. If both parties say "yes," there is a settlement. If either party says "no," there is no settlement. Importantly, in that situation, the mediator does not tell either party what the other side answered. That way, if one party said "yes" and the other said "no," the second party would not learn that the first party said "yes" to the proposal.

Sometimes the inability to reach a settlement may occur because of the unavailability of certain relevant information; this might include information on the treatment or compensation of other employees or information about aspects of the employee's damages (such as proof of other earnings or the employee's medical records). Or the parties may decide that they need a court ruling on some legal issue or that they need to await the outcome of some litigation event, such as a summary judgment motion. Sometimes, a party needs to consult with someone who is unavailable at the time. In such circumstances, the parties may agree to adjourn the mediation to another date, pending the further developments.

If the mediation session adjourns without a settlement, some mediators take the initiative to follow up with the parties later to determine whether further communications might be helpful. With or without such

intervention, many cases that do not settle during the mediation session do settle later, at least in part due to the progress made during the mediation.

8. The Settlement Agreement

When a settlement is reached during mediation, the parties should prepare and sign a binding agreement. Leaving the mediation without a signed (or at least initialed) agreement risks a broken deal; once the parties leave, "buyer's remorse" may set in and the deal could fall apart.

The types of agreements signed at the end of mediations range along a continuum of formality and finality. On one end is a simple "term sheet" initialed by the parties, subject to further negotiation of some terms and preparation of a formal document. On the other end is a formal, final agreement signed by the parties. In between might be a simple binding agreement, signed by the parties, outlining the terms and types of provisions to be included in a more definitive agreement to be prepared. The further along this continuum the agreement is, the better.

Sometimes, a formal final agreement is not possible, due to unresolved issues, absence of a prototype agreement as a foundation, absence of the equipment to prepare the draft, or simply lack of time, energy, or will at the end of a tough mediation session. Every effort should be made to prepare the best agreement that the circumstances allow. The more issues and language that remain open, the greater the risk of a significant delay in finishing the deal and the greater the risk of the deal falling apart.

One way to maximize the possibility of a formal final agreement is for counsel to bring a laptop containing a prototype agreement, including typical provisions and optional clauses. An optimistic counsel might even have in the laptop a tailored agreement ready to be modified to reflect the actual deal.

The settlement agreement should include a dispute resolution provision. Typically, such a provision will provide that, if a dispute arises, the parties will mediate the dispute with the same mediator and, if such mediation fails, will submit the dispute to arbitration. The arbitration provision should specify the arbitrator or the process for selecting the arbitrator, which may consist of referral to an organization to administer the process. The arbitration provision should also address such matters as the location and the governing rules for the arbitration.

The executive's attorney should also include a provision that, in arbitration, the arbitrator will have the authority to award attorneys' fees and costs to the prevailing party. Absent such a provision, the employee may have to absorb the attorneys' fees and costs incurred in enforcing the agreement. Note that the suggestion is to give the arbitrator the authority to award fees and costs, not the obligation to do so; if the executive loses the arbitration, the arbitrator probably would not make such an award against the executive unless the executive's position was frivolous or in bad faith.

Whether an oral agreement or a signed "term sheet" is an enforceable agreement depends on the intention of the parties and is governed by general principles of contract law. Importantly, under the Older Workers Benefit Protection Act (OWBPA), an employee's rights under the ADEA cannot be effectively released unless the employee is allowed up to 21 days to consider the release agreement and has had 7 days to revoke the release after signing it; the revocation period cannot be waived.

Often, the mediator is available and able to help the parties resolve any issues or disagreements that arise during the drafting of the full agreement. Notably, however, standard mediation agreements provide that the parties will never call the mediator as a witness in any dispute over the settlement or otherwise cause the mediator to disclose any aspect of the mediation process or the settlement.

The agreement signed at the end of the mediation should also be signed by counsel for the parties to show that they represented their clients during the negotiation and drafting of the agreement and that they approve the form of the agreement.

E. Arbitration

1. Characteristics of Arbitration

Arbitration employs a private third-party decision maker to listen to the parties' evidence and arguments and to render a decision. Unlike mediation, which is based on mutual problem solving and a collaborative approach to the dispute, arbitration is based on the conventional adversarial model of dispute resolution. Typically, the parties agree beforehand that the arbitrator's decision will be final and binding, though the parties could agree that the decision is merely advisory.

Compared with judicial litigation, arbitration is presumably faster and cheaper, although not necessarily as fair and just. One advantage of arbitration is finality—the dispute is over (whether or not the result is right or just), without recourse to review or appeal (except on limited grounds, such as bias or fraud). Other commonly cited "benefits" of arbitration include little or no discovery, relaxed rules of evidence, no juries, no motion practice, short decisions, and (according to some) limited remedies. As discussed below, these attributes of arbitration raise serious concerns for executives and their attorneys.

2. Comparison of Labor Arbitration with Employment Arbitration

Traditional labor arbitration is somewhat similar to, but really quite different from, arbitration of individual employment disputes, particularly those involving statutory discrimination claims. Traditional labor arbitrators typically confine themselves to determining the facts and applying them to the language and standards of a collective bargaining agreement. Moreover, the parties to a traditional labor arbitration are an employer and a union, not an individual employee; indeed, individual employees typically lack standing to initiate and control such arbitrations. Such arbitrations arise in the context of the institutional concerns and relations of the employer and the union. Most labor arbitrators have little or no knowledge of or experience with discrimination claims, which involve complicated issues of statutory interpretation, case analysis, and evidentiary judgments.

3. Method of Choosing Arbitration

A threshold issue pertaining to arbitration of employment disputes is the manner in which arbitration was supposedly chosen by the parties. Attorneys for employees have no problem with so-called postdispute arbitration, i.e., when the parties to a dispute enter into an agreement to submit a pending dispute to final and binding arbitration. In that context, the parties have the obvious incentive and opportunity to negotiate the rules and standards for the arbitration, such as how much discovery will be conducted and what remedies are available. On the other hand, attorneys for employees uniformly object to so-called predispute arbitration, which some employers seek to impose on employees as a condition of initial or continued employment (or as a condition for a raise or promotion). In the view of plaintiffs' employment attorneys, such "cram down" arbitrations are tantamount to adhesion contracts and are seldom truly knowing and voluntary.

4. Mandatory Predispute Arbitration

Predispute arbitration provisions have been the subject of much discussion and debate in the employment law community, especially after the U.S. Supreme Court's decision in *Gilmer v. Interstate/Johnson Lane Corp.*⁴⁷ Virtually every neutral or objective body that has examined the issue has concluded that such predispute arbitration provisions are inappropriate when imposed as a condition of employment, especially for discrimination claims.⁴⁸ Although anathema to most employee attorneys,

⁴⁷ *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 111 S. Ct. 1647, 1 EXC 165 (1991).

⁴⁸ See, e.g., U.S. SECRETARIES OF LABOR AND COMMERCE, COMMISSION ON THE FUTURE OF WORKER-MANAGEMENT RELATIONS 33 (Dunlop Commission Report, Dec. 1994).

courts have generally accepted mandatory pre-dispute arbitration clauses for contractual disputes and statutory discrimination claims as part of the "liberal federal policy" favoring arbitration.⁴⁹ Courts regularly enforce mandatory pre-dispute arbitration clauses to require arbitration of statutory discrimination claims, as long as they meet certain minimum procedural safeguards.⁵⁰ Generally it is enough that the employee continues his or her employment after being notified of a mandatory arbitration policy.⁵¹

Discussion of the legality, enforceability, and appropriateness of such mandatory predispute arbitration is beyond the scope of this chapter.

5. Minimum Due Process Standards

Whenever any employment dispute is submitted to arbitration, certain minimum standards of due process must be met. As a constitutional matter, due process is not required because arbitration is a matter of contract between two private parties and does not implicate state action.⁵² Instead, courts have evaluated the procedural requirements of arbitration under the unconscionability doctrine, which is a creature of state contract law.⁵³ As a general matter, arbitration must provide an effective means of vindicating one's rights.⁵⁴

In *Cole v. Burns International Security Services*, the court citing the standards discussed in *Gilmer v. Interstate/Johnson Lane Corp.*, said that, at a minimum, the arbitration arrangement should: (1) provide for neutral arbitrators, (2) provide for more than minimal discovery, (3) require a written award, (4) provide for all of the types of relief that would otherwise be available in court, and (5) not require employees to pay either unreasonable costs or arbitrators' fees or expenses as a condition of access to the arbitration forum.⁵⁵

6. Policy Considerations

In addition to such issues of voluntariness and due process, cramming employment discrimination claims into compulsory arbitration raises important issues of policy. Antidiscrimination statutes promote paramount social and legal policies against discrimination in employment. Such policies could be thwarted or weakened by pushing discrimination claims out of the courts and into arbitrations. Obviously, discriminatory conduct by employers would be less likely to come to the attention of the public if the claims are determined in private arbitrations.

⁴⁹ *Moses H. Cone Mem'l Hosp. v. Mercury Const'r Corp.*, 460 U.S. 1, 24 (1983).

⁵⁰ See *Circuit City Stores v. Adams*, 532 U.S. 105 (2001)).

⁵¹ See *Caley v. Gulfstream Aerospace Corp.*, 428 F.3d 1359 (11th Cir. 2005) (mandatory arbitration provision enforceable where employee had notice of policy and continued his employment, notwithstanding fact that no signature was required); accord *Campbell v. Gen. Dynamics Gov't Sys. Corp.*, 407 F.3d 546 (1st Cir. 2005) (requiring heightened level of notice for arbitration of statutory discrimination claims to be "appropriate" under the ADA or Title VII).

⁵² *Desiderio v. Nat'l Ass'n of Sec. Dealers Inc.*, 191 F.3d 198, 206 (2d Cir. 1999)

⁵³ *Cap Gemini Ernst & Young U.S., LLC. v. Nackel*, 346 F.3d 360 (2d Cir. 2003).

⁵⁴ *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79, 90, 2 EXC 35 (2000).

⁵⁵ *Cole v. Burns Int'l Sec. Servs.*, 105 F.3d 1465, 1483, 1 EXC 307 (US App. D.C. 1997); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 111 S. Ct. 1647, 1 EXC 165 (1991).

Moreover, given that arbitrators' decisions are not reviewable or appealable (except on very narrow grounds), the enforcement of the anti-discrimination laws could not be monitored or protected, arbitrators could ignore or misapply the dictates of the law without recourse, and the law would not be subject to development and clarification. If arbitration of employment discrimination claims becomes more prevalent, it may be necessary to adopt standards for greater scrutiny of arbitrators' decisions to ensure compliance with statutory standards.

7. Self-Regulatory Organizations

Predispute requirements to arbitrate employment claims have become common in the securities industry. Indeed, in the *Gilmer* case,⁵⁶ the plaintiff was required to arbitrate his age discrimination claim through the New York Stock Exchange arbitration process based on the arbitration requirement incorporated in the standard Securities and Exchange Commission registration form (U-4) executed by all registered representatives in the securities industry.

Major changes have occurred in securities industry arbitrations. The National Association of Securities Dealers (NASD) eliminated the arbitration requirement from the Form U-4 with respect to statutory discrimination and harassment claims filed on or after Jan. 1, 1999. Notably, that rule change did not apply to other kinds of employment claims against NASD members (e.g., common law discharge or compensation claims).

Moreover, NASD continues to provide a forum for arbitration of all claims, including statutory discrimination claims, pursuant to (1) a postdispute agreement to arbitrate, or (2) a "predispute" agreement between an employee and a member employer, even when the predispute agreement was "mandatory."

In granting its approval of the rule change, the SEC stated that "[t]he statutory employment anti-discrimination provisions reflect an express intention by legislators that employees receive special protection from discriminatory conduct by employers. Such statutory rights are an important part of this country's efforts to prevent discrimination. It is reasonable for the NASD to determine that in this unique area, it will not, as a self-regulatory organization, require arbitration."⁵⁷

The New York Stock Exchange went even further. Effective Jan. 1, 1999, the NYSE declined to provide a forum for *any* "predispute" agreement to arbitrate statutory discrimination claims. The Form U-4 arbitration requirement was eliminated for such claims, as were all employer-imposed mandatory arbitration requirements.

In addition to these rule changes, some leading employers in the securities industry (e.g., Merrill Lynch) have announced that they will not impose arbitration of statutory discrimination and harassment claims.

F. Hybrids of Mediation and Arbitration

Mediation and arbitration are fundamentally different in form and substance. Mediation requires a cooperative, problem-solving approach with the mediator and the other side; arbitration calls for a more adversarial approach, as each party tries to convince the arbitrator to rule in its favor. Nonetheless, some aspects of mediation and arbitration can overlap.⁵⁸

⁵⁶ 500 U.S. at 20.

⁵⁷ Self-Regulatory Organizations; NASD, Inc.; Order Granting Approval to Proposed Rule Change Relating to the Arbitration of Employment Discrimination Claims, SEC Release No. 34-40109 (June 22, 1998) (§IV), 63 Fed. Reg. 35,299, 35,303 (June 29, 1998).

⁵⁸ See *Alternative Dispute Resolution in the Executive Employment Context*.

1. Mediation With Testimony

In some mediations, one party may want to have witnesses (particularly the executive) "testify" in the presence of the mediator and the other side. This allows the witnesses to have their "day in court" and enables the observers to assess them as possible trial witnesses. After such a "mini trial," the parties can then turn to conventional mediation.

2. Mediation-Arbitration

Mediation-arbitration (med-arb) entails the neutral acting as a mediator to bring about a settlement and then, if mediation fails, acting as an arbitrator to decide the dispute. Experienced attorneys and neutrals generally consider such a procedure to be a distortion of both mediation and arbitration. The mediation process is corrupted because the parties and their attorneys will be reluctant to be open about their needs, wants, and interests and about the weaknesses of their positions and the strengths of the other side's positions. The arbitration process is corrupted because the arbitrator will have learned many things about the parties and their positions that would not have been admitted into evidence in a hearing.

3. Arbitration-Mediation

"Arb-med" avoids those problems. In such a proceeding, the parties arbitrate the case in the usual way and the arbitrator prepares an award; the award is sealed. Before unsealing the award, the arbitrator can act as a mediator to help the parties reach a settlement, rather than relying on the unknown award. An advantage of this approach is that the arbitrator has had the benefit of a full adversarial hearing and therefore has a good sense of the strengths and weaknesses of the parties' positions. Moreover, in this situation, the parties negotiate during the mediation with the real and immediate realization that, absent a settlement, a resolution will be imposed by the arbitrator.

4. Baseball Arbitration

This form of arbitration is used to resolve pay disputes between baseball owners and players. After the arbitration hearing, each party submits its best "offer" to the other side, and the arbitrator is required to select one of the two "offers" as the award.

5. Nonbinding Arbitration

Sometimes called "advisory arbitration," this process involves the parties going through an arbitration and receiving an award. Each party remains free to litigate the case in court. The result of the arbitration may or may not be admissible in court, depending on the parties' agreement. Similarly, the parties might agree that, if one party rejects the arbitration award and goes to court (while the other party accepted the award), the rejecting party would pay the costs and/or attorneys' fees of the other party if the rejecting party does not achieve a better result from the court.

Similar to the dynamics of arb-med, a nonbinding arbitration award may lead to a settlement, based on the terms of the arbitration award itself or other negotiated terms.

6. Partially Binding Arbitration

Under this process, the arbitrator's award may be binding as to only part of the case (e.g., liability and/or causation but not damages) or as to only one party (e.g., the employer). Some employers with dispute resolution procedures have arbitration as the final step under which the company is bound by the result but the employee is not. This process mitigates many of the problems caused by mandatory "pre-dispute" binding arbitration because the employee retains the right to take the claim to court. On the other hand, to the extent that this process is "mandatory," it may impose undue hardships on the employee (e.g., attorneys' fees in prosecuting the arbitration).

Substantial experience with such programs demonstrates that very few employees exercise the right to go to court after the arbitration. This might be because the employee was satisfied with the result (even if it was less than the employee wanted). Or it might be because the employee felt that, whatever the outcome, he or she had a "day in court" and had a fair opportunity to present the case. Or it might be because the employee was exhausted, emotionally or financially, and was unable or unwilling to continue the fight. Whatever the reasons, some companies have concluded that this process works to resolve fully virtually all claims.

IV. Negotiating and Drafting Settlement Agreements

A. Overview

1. The Context of the Settlement

This section addresses the negotiation and drafting of settlement agreements for employment disputes. Settlements may come from direct negotiations between the parties (or their respective counsel), from mediation, or from negotiations before or during arbitration proceedings. These contexts share many of the same substantive issues, and thus many negotiation and drafting issues are similar. When the context presents special issues, they will be specifically addressed.

2. Severance Agreements

On termination of an executive's employment, most employers provide severance benefits, typically in exchange for a release of claims against the employer. Moreover, many employment disputes arise because the employer terminates or threatens to terminate the employment relationship. Some employment disputes—involving current employees—result in a negotiated termination or resignation of employment.

All of these situations raise severance issues, so they usually result in an agreement containing provisions typically found in severance agreements. Accordingly, this section, in addition to addressing general aspects of settlement agreements, highlights negotiating and drafting issues common in severance agreements.⁵⁹

3. The First Draft of the Agreement

It is customary for the employer's counsel to prepare the initial draft of a settlement agreement involving an employment dispute.⁶⁰ Thus, the executive's counsel is usually in the position of reviewing and

⁵⁹ For further discussion, see *Executive Compensation Issues for Emerging Companies*.

⁶⁰ Almost invariably, a *severance* agreement will be drafted by the employer's counsel and presented to the executive (or the executive's counsel).

responding to a document prepared by the other side. Typically, that initial draft will be one-sided—maybe even outrageously so. Moreover, the executive's counsel has little direct control over the timing of that draft.

One way to avoid this situation is for the executive's counsel to take the initiative and prepare the draft agreement. Of course, this results in more work for the counsel, at least initially. Some executive's counsel are more than willing to cede the drafting to the other side, particularly when the counsel is working on a contingency basis. However, ceding control over the first draft allows the employer's counsel to determine when the document is ready,⁶¹ what terms are covered, and what language to use to express the terms.

Preparing the first draft can be a tactical benefit, especially in negotiating terms that were not clearly and completely addressed in the predrafting negotiations. Thus, taking the initiative helps ensure a balanced and fair first draft, as well as improving both the substance and the timing of the final agreement.

Typically, once the broad terms of a settlement have been agreed on, the executive is eager to get the paperwork done and receive the settlement proceeds. The employer, on the other hand, has little incentive to expedite the process, unless some external deadline (e.g., a trial date) is imminent. Indeed, employers sometimes prefer to move slowly if for no other reason than to delay writing the settlement check. Thus, in the final predrafting stage of negotiations, an executive's counsel should try to get a firm commitment from the other side on the timing of the process, including the date for payment of the settlement proceeds.

To induce the employer to expedite the process, the executive's counsel should try to build financial incentives into the settlement. The most obvious way to do that is to provide for interest on the settlement proceeds at a high rate beginning on a specified date, such as 10 days after the broad terms of agreement are in place. Another approach is to require the employer to deposit the settlement proceeds into an interest-bearing escrow account, held by the executive's or the employer's counsel pending the consummation of the deal, with the interest going to the executive. This approach removes the incentive for the employer to move slowly in writing the settlement check.

4. Reciprocity and Mutuality

After agreement is reached regarding the key financial and nonfinancial terms of a settlement, the executive's counsel should focus on other terms that are sometimes overlooked altogether or overlooked until the executive's tactical leverage is reduced. These terms include a release in favor of the executive, a favorable oral or written reference, a nondisparagement clause in favor of the executive, and effective enforcement mechanisms for the employer's obligations under the agreement.

A useful tactic for the executive's counsel during negotiations on nonfinancial issues is to insist on reciprocity and mutuality—"what's good for the goose is good for the gander." Once that principle is established, the employer's counsel will be less likely to insist on extreme provisions in the agreement (e.g., an onerous liquidated damages clause), and a balanced settlement agreement is more likely. These issues are addressed in detail later in this section.

B. Severance Agreements—Special Issues

1 In General

⁶¹ Employer's counsel will invariably insist on having the employer review and approve the draft before sending it to executive's counsel. Thus, even when the employer's counsel is reasonably prompt in preparing a draft, which is often not the case, the employer's review frequently delays the process longer than the executive and the executive's counsel would like.

As discussed earlier, a severance agreement is a type of settlement agreement. Typically, severance agreements are prepared unilaterally by the employer's counsel and presented to the executive to sign; negotiations over the terms may then ensue. These negotiations may raise some special issues. For example, should the executive negotiate for a better package or agreement? In this case, the answer is generally "yes" (that is, generally it does not hurt to ask).

2. Whether to Negotiate

The answer to the question of whether one should negotiate is "it depends." Frequently, the executive should try to negotiate an enhanced package, with counsel in the background. This approach is less expensive for the executive and is also less confrontational. In addition, it is often far more effective, particularly when the executive's negotiating leverage is based more on personal and political factors than on legal ones. In these situations, direct intervention by the executive's counsel can be counterproductive because it appreciably changes the dynamics of the negotiations, usually precipitating direct involvement by the employer's counsel, who is likely to focus on the legal merits of the executive's position rather than those personal and political factors that better serve the executive's interests.

If the executive is unable or unwilling to negotiate directly or if that approach appears unpromising or has been tried but failed to achieve an acceptable result, then the executive's counsel can step forward to deal directly with the employer or the employer's counsel. Generally, little is lost by trying this incremental approach. Even when it does not work, the executive and the executive's counsel may learn about the strengths and weaknesses of their bargaining position in the process.

3. With Whom to Negotiate

When the executive decides to negotiate directly with the employer, choosing the person with whom to negotiate is an important tactical decision. Sometimes, the proposed severance agreement or a cover letter specifies who will handle any questions about the agreement. The executive should not feel constrained by that designation since the designated person often is not the best person with whom to negotiate. The executive or the executive's counsel should try to identify someone in the company who has both the power and the inclination to help the executive. Often, the executive is better off negotiating with people in his or her management chain, that is, someone the executive has worked with rather than people in the human resources or counsel's offices. Moreover, the executive generally is better off negotiating with a human resources representative rather than a company attorney.

4. How to Negotiate

A key to any severance negotiation is determining what negotiating leverage the executive has and can use. The amount of leverage depends on the situation. If the executive has a strong (or at least colorable) legal claim, that is critical leverage, although occasionally it pays to hold it in reserve. Absent a legal claim—or before asserting one—the executive can try to "push the buttons" of the employer through people in the company who know and like the executive. The "buttons" include fairness, guilt (a great motivator), fear (of bad publicity, the government, or higher management), and friendship.

An especially powerful button is the desire of many company officials to be perceived as fair and reasonable in the eyes of others, such as other executives, senior executives, directors or shareholders of the company, customers or clients of the company, or people in their industry. With some companies and some employees, these nonlegal factors work, especially for executives. This is especially true when proposed changes will cost the employer little or no money but will help the executive.

5. Standard Severance Policies

Typically, it is harder to negotiate potential changes in the context of a reduction in force. Employers often

say they cannot or will not make changes that could undermine the standard package or create a bad precedent. Even in the face of such a mindset, changes can be obtained—even substantial ones—through the creative approaches discussed below.

6. Withdrawal of Offer

Can the employer rescind or withdraw a proffered severance package during any consideration period if the executive asks for more? The answer is generally "yes," but this rarely happens. An executive's attorney is safe in assuming that the standard package provided under a company policy or an ongoing exit or reduction program will not be withdrawn. Under the OWBPA, moreover, the employer arguably cannot withdraw the offer during the 21/45 day consideration period.⁶² In any event, the consideration period is routinely extended; however, the executive's attorney should be alert to the risk that the employer might not extend it and should get written confirmation of any extension to the extent practicable.

7. COBRA

A discharged executive has the right under COBRA⁶³ to continue group health insurance or medical coverage, at the existing benefit level and rates for up to 18 months after the off-payroll date (up to 29 months if the executive is disabled under Social Security standards). The employer can require the employee to pay up to 102 percent of the cost of continuing this benefit coverage. Nonetheless, employers sometimes will agree to pay all or part of the COBRA premiums for some period of time.

C. Severance Agreements—Economic Terms

1. In General

Negotiating a severance agreement offers many opportunities to structure the economic terms beyond the mere payment of a lump-sum settlement amount. Some of these approaches can be adapted for use in structuring the economic terms of a settlement agreement in a nonseverance situation. Accordingly, those approaches are set forth here.

2. Severance Pay and Other Cash Compensation

a. Severance Pay Options

The basic options are lump sum and salary continuation. Typically, benefits end when a lump sum is paid, and some benefits continue during a continuation period, although exceptions occur both ways. Employers will sometimes negotiate a switch from one to the other at the executive's request.

b. Effect of Options

⁶² *But see Ellison v. Premier Salons Int'l Inc.*, 981 F. Supp. 1219, 1 EXC 397 (D. Minn. 1997) (holding that the 21 day review period is relevant only to the issue of whether an employee's waiver of his or her rights under the ADEA was knowing and voluntary and that OWBPA does not provide for an irrevocable power of acceptance).

⁶³ 29 U.S.C. §1161 et seq.

During a salary continuation period, employers often will continue to pay for health/medical benefits on the same terms as during active employment, although the employer can require the employee to pay up to 102 percent of the cost. Employers sometimes will continue other benefits, such as life insurance coverage, pension or 401(k) contributions and accruals, and vesting under stock plans, and so on. Employers generally do not continue disability benefits or vacation and sick day accruals during a salary continuation period, although sometimes vacation accruals can be negotiated.

c. Termination of Severance Pay

An important negotiating point is whether continuation pay will end when the executive gets a new job. Some severance arrangements provide this; such a provision may or may not impose a duty to mitigate on the executive. Other arrangements provide that the executive may choose to cease continuation pay and obtain a lump-sum payment for the balance on starting a new job or merely on request. Of course, if the proposed agreement contains a defeasance or mitigation provision or lacks an option to choose a lump-sum payment, the executive should try to negotiate for a change.

An executive who is concerned about the prospect of running out of severance pay before finding a new job may try to negotiate a trade-off—exchanging a fixed duration of severance pay for a potentially longer variable duration, depending on when the executive gets a job. For example, in lieu of 26 weeks of fixed severance pay, an executive may prefer to receive severance until (and only until) reemployment, which could happen after only 10 weeks or after 40 weeks. In such a situation, the employer will always insist on a time limit and may insist on a duty to mitigate. Sometimes a combination of fixed and variable pay is negotiated, providing a floor and a ceiling.

A modified arrangement sometimes is negotiated to meet the executive's security objectives (i.e., limiting the risk of missing paydays), while meeting the employer's concern that the executive will not make appropriate efforts to find a job. For example, under a variable payment arrangement with an outside date, the executive may receive pay until reemployment and then split (e.g., 50/50) with the employer the amount of severance covered by the remainder of the severance period. This shares risks and benefits.

d. Incentive Compensation

Severance pay is typically based on base salary and does not include bonuses, incentive pay, commissions, and so on. Nonetheless, executives should be alert to opportunities to lay claim to such compensation. Employers will often argue that incentive compensation is discretionary or is not payable to executives who depart before the payment date for such compensation. Sometimes, however, the executive may have been given an oral or written assurance of a minimum or guaranteed bonus (such as in an offer letter). Even without that, an executive may be able to make a strong equitable claim for at least a pro rata bonus. Such a claim can have special merit toward the end of the business year when the compensation would normally be paid, especially if the executive has met most or all of the applicable standards for the extra compensation. Those claims can be quite substantial.

3. Leave Pay

It is always important to ascertain the executive's entitlement, or potential claim, to accrued but unused vacation or other leave pay. Sometimes, the whole year's allotment can be obtained; other times, only the pro rata portion is allowed. The employer's manuals and policies should be consulted and what other executives have received previously should be considered. Increasing the amount of vacation pay is a way to enhance the package without "breaking the mold" of the standard package.

4. Creative Approaches

When an employer refuses to alter a standard severance pay amount or period, executive's counsel should look for creative ways to improve the package "around the edges" while leaving the core intact. Examples of such improvements include the following:

- Defer the effective date of the termination. This could be in the form of a "notice period" or simply continued employment. If the off-payroll date is postponed, the executive gets paid longer before getting the standard package. It may be understood (or better, stated) that the executive will not be expected to perform any or much service during all or part of the extended period, presumably while looking for a new job.
- Add a consulting agreement (discussed later).
- Convert some benefit to cash. For example, if the executive does not need proffered outplacement services, occasionally an employer will allow the cost of that service to be "traded in" for cash; this can be as much as 15 percent of the executive's salary. Similarly, if the executive does not need medical coverage (e.g., when covered under a spouse's plan), the cost of such coverage might be traded in.
 - Get more money allocated to incentive compensation or to leave pay (see above).
 - Agree to a restrictive covenant, such as a covenant not to compete or to solicit customers or employees, which has value to the employer (see below).
 - Consider tax issues (see below).

5. Offsets

In most states, employers are not allowed to offset unilaterally against "wages" any amount that the employer contends the employee owes the employer (e.g., cash advances, loans, alleged thefts).⁶⁴ Nonetheless, employers can require an employee under some circumstances to allow an offset as a condition for receiving certain consideration, such as a loan or advance.

6. Benefits

As discussed earlier, COBRA provides a right to continued medical coverage, and some benefits are commonly extended during a salary continuation period. In any event, as to all benefits, executives should gather all pertinent information as soon as possible, including benefit and account statements, plan documents, summary plan descriptions, and so forth. This is especially applicable to any severance plan documents. With these documents, the executive and counsel can assess the effects of the severance on those benefits—what is being preserved and what may be lost (e.g., due to inadequate accrual or vesting). This process can identify problems, clarify ambiguities, and locate improvements that can benefit the executive, often without substantial cost to the employer.

Executive's counsel should be alert to the possibility that the employer might be terminating the executive *for the purpose* of preventing the executive from obtaining a benefit (e.g., vesting in a pension). Although this is obviously hard to prove, such a purpose could violate §510 of ERISA.⁶⁵

When the executive is close to, but short of, a date for accruing or vesting some benefit, ways to bridge to that date should be negotiated. This is especially applicable to pensions, 401(k) matching contributions,

⁶⁴ See, e.g., N.Y. LABOR LAW §193.

⁶⁵ Similarly, if an employer terminates an executive for the purpose of preventing the executive from obtaining compensation (e.g., a large commission or bonus), there may be a breach of the implied covenant of good faith and fair dealing. See *Wakefield v. Northern Telecom, Inc.*, 769 F.2d 109, 1 EXC 214 (2d Cir. 1985), *subsequent proceeding*, 813 F.2d 535 (2d Cir. 1987).

deferred compensation plans, and stock plans. Ways to do this include getting a longer severance period, spreading the same severance pay over a longer period, getting an authorized leave of absence (i.e., continuing employment status without pay), or getting credit for some prior service with the employer or a predecessor in interest.

With respect to nonqualified plans (e.g., some deferred compensation and stock option plans), it may be possible to obtain accelerated or continued accrual or vesting, particularly when the executive was terminated without cause. Sometimes an employer can be persuaded to provide some cash in lieu of a forfeited benefit.

7. Consulting

Sometimes it is advantageous for both the employer and the executive to enter into a consulting agreement after the end of employment. The employer may have continued use for the executive's expertise, contacts, or institutional memory, and the executive can obtain additional income that may not interfere with other employment.

Sometimes, a consulting agreement is a way for the employer to ensure the executive's good will, avoid trade disparagement, or obtain a covenant not to compete or not to solicit clients or employees. A consulting agreement is a way for the executive to obtain more money in exchange for something of real value to the employer, which makes it easier to negotiate.

Sometimes, a "no show" consultancy can be arranged. For example, the executive may be paid to "be available" or to be "on call." Obviously, executive's counsel should be careful to ensure that the agreement is not drafted in a way that imposes real, significant obligations as a condition for payment, if that is not the intent. Otherwise, the employer could stop payments for alleged nonperformance. Consulting agreements are especially useful when the employer does not want to alter a standard package but is otherwise willing to improve the deal.

8. Attorneys' Fees

The executive's counsel should try to get the employer to pay the executive's attorneys' fees for reviewing and negotiating the agreement. Payment of attorneys' fees may be traded off against other amounts that would be subject to employment taxes, thereby saving both parties some taxes. With the passage of the Civil Rights Tax Reform Act in 2004, attorneys' fees associated with a claim for discrimination may be deducted above the line, thus essentially making them fully tax-deductible.⁶⁶ The definition of "discrimination" for purposes of deductible attorneys' fees includes most statutory employment rights as well as those under any statute or common law "regulating any aspect of the employment relationship."⁶⁷

9. Outplacement Services

Some employers offer professional outplacement services. For some executives, particularly those who have not been in the job market for a long time, these services can be very helpful. If this option is not offered and the executive could benefit from it, the executive should ask for it. If the executive does not need or want such outplacement services, the employer may be willing to trade the cost for cash. Some employers refuse to do so, however, taking the position that the outplacement service is offered to help the executive find a new job/career and the executive can take it or leave it.

⁶⁶ 26 U.S.C. §62(a)(20).

⁶⁷ 26 U.S.C. § 62(e)(18)(ii).

In the absence of professional outplacement assistance, the executive may ask for and obtain help from the employer in looking for a job. The ability to use a company office, secretarial and reception services, a telephone, voice mail, e-mail, and photocopying and other services can be a substantial benefit, especially when it helps preserve the appearance that the executive is "looking for a job from a job."

10. Property and Perquisites

The executive's counsel should be alert to issues involving personal property, such as the executive's Rolodex (or electronic equivalent), personal papers and files, copies of some "business" documents, and office furnishings. As to documents, ascertain whether a confidentiality agreement is already in place. If so, it may govern the executive's rights to keep, obtain, or use certain documents. Employers sometimes allow executives to keep (or purchase at a reduced price) such company property as the executive's personal office computer, laptop, personal digital assistant, home fax machine, cellular telephone, or even company car.

11. Unemployment Insurance

The executive's counsel should always remind the terminated executive of the right to collect unemployment insurance (UI) benefits. Those benefits are not payable until the executive applies. UI benefits are not payable to executives who quit without sufficient reason or are fired for misconduct. The executive and/or his or her counsel should ascertain what the employer will tell the UI office regarding the termination and have this acknowledged in the agreement. Generally, UI benefits are payable regardless of whether lump-sum or fixed-period severance payments are made but are not payable while the executive is on the active payroll (e.g., during a "notice period"). It appears that these distinctions are not uniformly applied. If an executive is denied UI benefits improperly, an appeal can be filed. Initial determinations are often reversed on appeal.

D. Tax Considerations in Settlements

1. Background

Before Aug. 20, 1996, it was sometimes possible to structure and allocate settlements so that some, or all, of the proceeds would not be subject to income taxes, specifically amounts received as compensation for emotional distress under tort or statutory claims.⁶⁸ At that time, I.R.C. §104(a)(2) was amended to permit exclusion from income only for damages received "on account of personal *physical* injuries or *physical* illnesses" (emphasis added). For these purposes, "emotional distress shall not be treated as a physical injury or physical illness," except to the extent of damages paid for medical care.

Under §104(a)(2) as amended, the opportunities for tax-free settlement amounts are all but eliminated. The remaining possibilities for tax-free or tax-deferred amounts include:

- damages received on account of *physical* injuries or illnesses (tax-free);
- damages paid for the costs of medical care (tax-free);
- amounts paid into tax-deferred accounts (e.g., 401(k)s and pension plans) (tax-deferred);
- employer contribution to a "rabbi trust" for the executive's benefit (tax-deferred);
- structured settlements, with payments made in later taxable years⁶⁹ (tax-deferred); and

⁶⁸ See *Commissioner v. Schleier*, 515 U.S. 323, 115 S. Ct. 2159, 1 EXC 158 (1995).

⁶⁹ Special care must be taken so that settlements are compliant with I.R.C. §409A. Section 409A provides that parties may elect the amount and timing of a separation payment resulting from an arms-

- attorneys' fees paid in connection with "discrimination" claims⁷⁰ (tax-deductible).

2. Payroll Taxes

Amounts received as compensation for interest, emotional distress, or punitive damages, although subject to *income* taxes, are not *wages* for purposes of FICA and other payroll taxes and contributions.⁷¹ Similarly, an amount paid as consideration for cancellation of a fixed-term employment agreement is not considered wages.⁷² Thus, for amounts allocated to such nonwage categories, the employer and executive can each save 7.65 percent on income up to \$97,500 for 2007 (subject, of course, to the effect of other wages during the year), plus 1.45 percent beyond that amount.

E. Other Severance and Settlement Issues

1. Releases and Waivers

In the settlement of an employment dispute or when an enhanced severance package has been negotiated, the employer invariably insists on a release of any and all claims and rights by the executive against the employer (and its agents, representatives, successors, assigns, and so forth). Likewise, many employers require such a release or a condition of receiving basic and/or enhanced severance benefits. For adequate consideration, such releases are fair and appropriate.

A waiver that does not conform to the requirements of the OWBPA⁷³ is ineffective as to ADEA rights. It would still be effective as to all other rights and claims, assuming it is otherwise knowing and voluntary and is not barred by some other statutory provision, such as those relating to minimum wage and

length negotiated settlement in connection with an involuntary termination at any point up until the employee obtains a legally binding right to the payment. Treas. Regs. §1.409A-2(a)(11). Such payments, however, cannot be used to change the timing or payment form of other deferred compensation payments to which the employee was already entitled.

⁷⁰ The position of the IRS is that the amount of attorneys' fees paid to the attorney by the employer is taxable income to the employee. *Commissioner v. Banks*, 543 U.S. 426 (2004). However, with the passage of the Civil Rights Tax Reform Act, attorneys' fees in connection with a discrimination action (broadly defined), paid either directly by the employer or by the employee, are completely excludable from gross income (i.e., an above-the-line deduction) and therefore are no longer taxed. 26 U.S.C. §62(a)(20).

⁷¹ Note that a Form W-2 tax report is issued for wages, a Form 1099 tax report is issued for nonwage income, and no tax report is issued for nontaxable payments.

⁷² See Rev. Rul. 58-301, 1958-1 C.B. 23; cf. Rev. Ruls. 74-252, 1974-1 C.B. 287, and 75-44, 1975-1 C.B. 15.

⁷³ 29 U.S.C. §626(f). The OWBPA requires that, for a waiver of ADEA rights to be deemed "knowing and voluntary" and therefore enforceable, the waiver must meet certain minimum standards, including the following: at least 21 days to consider the agreement (45 days in connection with an exit incentive or employment termination program offered to a group or class of executives); at least 7 days to revoke the agreement after signing; advice in writing to consult with an attorney before signing; and specific mention of waiver of ADEA rights.

overtime pay claims under the Fair Labor Standards Act and workers' compensation claims.

Releases included in separation agreements and settlement agreements prepared by employer's counsel are often unduly broad, perhaps unknowingly. For example, read literally, such releases often would encompass an executive's rights under benefit or compensation plans, vested or otherwise. Such a release would undoubtedly be unenforceable as to vested rights, but the release language should be clarified anyway. Similarly, the release language should exclude the executive's proprietary interests that may be associated with the employer, such as the executive's interest in investment funds, partnerships, or ventures and any securities or bank accounts the executive maintains with the employer. In any event, the executive's counsel should be sure to exclude specifically from the scope of the release all benefits and rights that should be excluded.

In appropriate circumstances, the executive's counsel should try to exclude from the release whatever existing rights the client has under any company liability insurance policy (e.g., director's and officer's liability) or under company defense and indemnification policies or practices (which are often provided by state law or in corporate by-laws or board resolutions). In the release, the executive's counsel should be careful not to forfeit reimbursement for business expenses; the executive should submit the expenses and get reimbursed before signing the agreement or at least reserve the ability to submit the expenses for reimbursement.

If the executive expects to preserve any rights under any other agreements or plans, the executive's counsel should ensure that they are incorporated into or mentioned in the settlement or severance agreement. Otherwise, they could be deemed released, particularly when the agreement has an integration clause.

A release by the employer of any rights and claims against the executive may be desirable or even essential. Employers often resist such releases, especially in a typical severance situation; mutual releases are more common in negotiated settlements of asserted claims. When a release by the employer is agreed to, employers sometimes want an exception for after-discovered claims, such as any claim for defalcation or theft, particularly when the executive's departure was fairly recent. Such exceptions must be narrowly tailored, and the executive's counsel should obtain a representation from the employer that it is aware of no basis for any such claims against the executive.

2. Confidentiality

Employers generally want the terms of a severance package to be kept confidential when an executive gets a nonstandard package. Generally, executives have no real problem with this, as long as they accept the financial terms. Such confidentiality provisions obviously make it harder for other executives (and their attorneys) to learn about enhanced severance terms—which is the whole point, from the employer's perspective.

The typical confidentiality clause contains some exceptions, but they are usually incomplete. The executive should ask for the following exceptions: (1) the executive's professional advisors (attorney, accountant, financial planner, and so forth); (2) the executive's immediate family (and perhaps other specified family, friends, and so forth); (3) tax and regulatory authorities; (4) any proceeding arising under or pertaining to the severance agreement; and (5) any subpoena or other compulsory legal process (although employers sometimes insist that the executive give prompt notice of any such process received, so the employer can move to quash).

The executive's counsel should be careful about *retroactive* application of a confidentiality clause, i.e., purporting to proscribe disclosures that the client may have made before the deal was made. (It is generally a good idea to advise executives to be discreet about settlement talks even before formal agreement is reached.) Also, it is good practice to be careful with any provision that makes confidential the "existence" or "fact of" the severance agreement; generally, try to limit scope to the terms of the agreement, unless a good reason exists for a broader scope. Particularly when the confidentiality clause is very broad, it can be useful to have a "safe harbor" clause, specifying what your client can say safely, if asked what happened (e.g., "we entered into an amicable resolution"). A review of case law reveals that confidentiality clauses are seldom the subject of litigation.

3. References and Nondisparagement

A good job reference can be very valuable to an executive. Forestalling a bad job reference can be even more valuable. An agreed-on reference letter is a good idea. It is often useful for the executive to draft a reasonable proposed letter that the employer should accept and then negotiate from that draft. The agreed-on letter can be annexed as an exhibit to the severance agreement. The letter can have two forms: a "To Whom It May Concern" letter that the executive can use any time and a standard letter to be sent out by the employer in response to any requests.

The content of the letter can also be the script for any oral references given. It is advisable to name specific individuals who are deemed acceptable to respond to any call for a reference and to obtain assurances that no one else will handle such a call. Failing that, it is advisable to reach an agreement in which, in response to any reference request, the employer will state that pursuant to standard company policy it can only confirm limited employment information (such as the last position held and the dates of employment).

Employers often seek nondisparagement clauses in favor of the company (including its officers, agents, products, and services). Executives often accept such clauses, although some limitations may be negotiated (e.g., statements pursuant to subpoena or court order or a "safe harbor" for statements made during job interviews or during legitimate competitive activities). Executives also may seek nondisparagement clauses in their favor. These are broader than provisions limited to job references. Employers sometimes object that a broad nondisparagement clause is impractical and unenforceable as applied to all of the company's employees. This objection can be countered by having the nondisparagement clause apply to certain categories of executives (e.g., all officers over a certain rank or in a certain division) or to certain named persons.

4. Restrictive Covenants

In some contexts, employers try to include in severance agreements restrictive covenants, such as a covenant not to solicit customers or employees (nonsolicitation), a covenant not to compete for a period of time within certain geographic and/or business parameters (noncompetition), or a covenant not to disclose confidential or proprietary information (nondisclosure). Sometimes, an executive may already be subject to such restrictions contained in prior agreements (such as employment agreements, compensation agreements, and stock or stock option grant agreements), and the employer may ask to confirm their continued validity or to extend their scope. Alternatively, the executive may seek to narrow or eliminate them.

These covenants present obvious limitations on the ability of many executives to earn a living after leaving the employer. A logical argument can be made that such restrictions should not extend beyond the end of the severance pay period in such circumstances. Put another way, severance pay should be paid for the entire duration of any such restrictions.

In most states, noncompetition and nonsolicitation covenants are enforceable to the extent that they protect an employer's legitimate protectible interests in trade secrets or confidential or proprietary information and that they are reasonable in time, place, and scope. Such covenants are treated differently in other states. Some states consider such covenants as promoting public policy and encourage them by statute or common law; other states (like California) consider such covenants to be against public policy and therefore totally or largely unenforceable. In most states, unreasonable provisions can be "blue penciled" to make them reasonable. Some states declare any unreasonable provision to be unenforceable, without "blue penciling" to preserve reasonable aspects.

One way of handling an employer's legitimate noncompetition or nonsolicitation concerns is to be very specific about what is prohibited. For example, the executive may covenant not to solicit *named* customers or employees for a period of time or not to compete as to *named* clients or products. A list can be attached as an exhibit to the agreement.

It is important to keep in mind the difference between nonsolicitation and nonhire. A clause that prohibits

an executive from soliciting co-workers to leave the employer would not prohibit the executive from actually hiring a co-worker who approaches the executive. The same thing applies to customers and clients.⁷⁴

5. Cooperation

Employers sometimes want to ensure that former executives will cooperate in the future if necessary for a lawsuit, claim, or regulatory matter as to which the executive has knowledge. For example, the employer's counsel may want to interview the executive or to have the executive available for an affidavit, deposition, or trial. While the executive is receiving severance benefits, the employer might have some self-help remedies when a former executive fails to cooperate. In any event, an employer may seek a written assurance of cooperation.

If the executive is willing to provide future cooperation, which is typically the case, some ground rules are appropriate. For example, it may be agreed that any cooperation must not interfere unreasonably with the executive's business or personal pursuits or that the executive will be available only outside business hours or up to a certain amount of time. Moreover, it is often advisable to negotiate a per diem or per hour compensation arrangement for such services, sometimes with a small amount of time (say, one day) provided free, plus assurance of reimbursement for all expenses. In addition, sometimes it is appropriate to seek a commitment that the employer will pay reasonable legal fees incurred by the executive in connection with such cooperation.

6. "Gag" Clauses

Employers sometimes seek to prohibit former executives from providing information to, or cooperating with, regulatory agencies or other persons who might have claims against the employer. For example, a clause might provide that the former executive may not file a charge with the EEOC, may not voluntarily assist the EEOC or any other administrative agency, may not voluntarily appear as a witness or party in any judicial or administrative proceeding in which the employer is a party, and must notify the employer of any subpoena and cooperate with any efforts by the employer to resist that subpoena.

These clauses present a tension between public policy considerations (i.e., encouraging and facilitating disclosure and investigation of potentially unlawful conduct by employers) and private considerations of the parties (i.e., the desire by an employer to try to ensure complete peace, which an executive may be willing to provide in exchange for appropriate consideration). Because of the public policy considerations, such gag clauses may not be enforceable.⁷⁵

7. Applications for Future Employment

Employers sometimes seek to preclude a former executive from ever seeking reemployment with the

⁷⁴ See ABA Section of Labor and Employment Law, COVENANTS NOT TO COMPETE: A STATE-BY-STATE SURVEY (Brian M. Malsberger ed., BNA Books 6th ed. 2006).

⁷⁵ See, e.g., *EEOC v. Waffle House, Inc.*, 534 U.S. 279 (2002) (although an employee signed a predispute arbitration agreement, the EEOC was not precluded from pursuing relief on employee's behalf because it was doing so to vindicate public interest); *Connecticut Light & Power Co. v. Secretary of Labor*, 85 F.3d 89, 1 EXC 194 (2d Cir. 1996) (employer's proposed settlement provision, which would have prohibited employee's voluntary appearance as a witness or party against the employer, found to violate the Energy Reorganization Act's antidiscrimination provision); *EEOC v. Astra, U.S.A. Inc.*, 94 F.3d 738, 1 EXC 184 (1st Cir. 1996) (settlement agreement clause that prohibited former employees from assisting the EEOC held to violate public policy).

employer, particularly when the executive has asserted claims against the employer. Some executives object to such a provision, considering it unfair and punitive. The usual rationale for such a provision is that it protects the employer from a discrimination or retaliation claim if it denies the former executive's subsequent application for a job. Typically, executives accept such a provision, although certain exceptions should be considered. For example, it is reasonable to exclude circumstances in which a future employer of the executive is acquired by or merged with the former employer, the executive applies for employment without realizing that the prospective employer is part of the former employer, or the parties knowingly agree to the new employment.

8. Liquidated Damages

Employers sometimes include a provision that the executive will forfeit or disgorge all or part of the severance package (or a certain sum of money) if the executive does certain things (e.g., sues on a released claim or violates a restrictive covenant or confidentiality clause). Obviously, such a provision should be opposed whenever possible and narrowed to the extent possible. In the latter event, it can be argued that a lower amount is sufficient to provide the desired incentive for the executive to comply.

Generally, the executive's risk of forfeiture or disgorgement is not a problem when the triggering event is something well within the executive's control, such as suing on a released claim. A real risk may exist, however, when the triggering event is less readily controllable or identifiable, such as an alleged breach of confidentiality or of a restrictive covenant. One way to limit the risk is to insist that the employer provide advance written notice of any alleged breach and a reasonable opportunity to cure, when it is possible to do so. In addition, making such provisions reciprocal can provide protection for the executive and can result in more moderate terms.

9. Dispute Resolution and Attorneys' Fees

Employers sometimes include a provision that any dispute under a settlement or severance agreement will be resolved through arbitration. Even so, such employers may provide that they reserve the right to go to court to seek injunctive relief for violation of the executive's commitments, such as restrictive covenants. Even when the employer does not include an arbitration clause, executive's counsel should consider suggesting one. Arbitration can be an effective, inexpensive, and speedy way of enforcing or defending rights and obligations under a settlement agreement. A provision stating that, before commencing any arbitration or litigation, the parties will enter into direct, good faith negotiations and will try mediation is also advisable.

If the settlement is the result of a mediation process, the settlement agreement should include a provision that, if any disagreement arises regarding the interpretation or implementation of the agreement, the parties and their counsel will discuss the disagreement with the mediator before any legal proceedings are commenced. It is generally in the executive's interest to include a provision that, in the event of a dispute, the arbitrator or court will have the authority to award reasonable attorneys' fees and costs to the prevailing party.

F. Conclusion

With careful attention to all aspects of negotiating and drafting the settlement agreement, the executive's attorney can materially advance the client's economic, practical, and legal interests under the final agreement signed by the parties.

Copyright©2007 by The Bureau of National Affairs, Inc., Washington D.C.