Compensation Negotiation: It's Not Just About How Much You'll Make

May 27 2011 by Jon Vegosen

When it comes to executive compensation, most executives joining a new employer focus on "how much" and not "how can I lose?" While "how much" is the number one question, equally critical are (1) protection from arbitrary termination of employment, and (2) what happens to the options and deferred compensation if one's employment ends. Too often, executives focus only on how much they will be receiving (assuming all goes well), and not enough on protecting themselves if the relationship sours. And they often fail to consult with an attorney who can help provide them with the protection they need.

For example, let's look at what happened to one of my clients. To protect his identify, we'll call him Mike. Mike had owned his own business, and he sold it when he was in his early 30s. He received a nice price for his company, but it wasn't nearly enough to retire. Mike found an outstanding position as the vice president of sales for an up-and-coming hi-tech business. Mike was very proud of the employment agreement he negotiated for himself with his new employer. He had a handsome salary, the ability to earn a bonus up to 75 percent of his salary, and options for half a million shares of common stock at $10 a share. Mike was sure the stock would quadruple by the time his shares fully vested in five years. He knew he was going to become a multi-millionaire.

Mike had a very good run with his employer. He achieved excellent sales and earned outstanding bonuses. About four years after later, however, Mike was fired. Why? Not because he had done anything wrong or because his performance had been lacking. Mike had a couple of new bosses. They tersely told that him he no longer fit in and they wanted to move in a different direction with sales. Although Mike's new superiors wouldn't admit it, the real reason they fired Mike was because they wanted his stock options for themselves.

The employment agreement Mike had signed — without showing it to an attorney — made him an "at will" employee. This meant that Mike could be fired at any time, without cause and without notice. Moreover, there was nothing in Mike's agreement to protect him from losing his stock options if he was discharged. This was because Mike's options "cliff vested" – which meant they did not vest on a pro rata basis each month or even each year. Rather, they would only vest at the completion of the full five-year period set forth in Mike's agreement. Moreover, there was no clause in the agreement that accelerated Mike's stock options if his employment were to be terminated without cause before his options had vested. So, Mike was hung out to dry, all because (1) he had been so focused on "how much" he would be earning, rather than on protecting what he could earn, and (2) he had represented himself in the negotiations rather than engaging an attorney to look out for his interests.

When Mike's employment was terminated, the stock of his employer was trading at $24 per share. He was leaving on $7,000,000 on the table. Mike was flabbergasted and furious. He had worked so hard and thought he was on the brink of reaping a huge payday, only to have had the proverbial rug pulled out from under him. Mike retained our firm to determine if he had any recourse. From a contractual standpoint, Mike had none. At-will employment and cliff vesting provisions are usually enforceable. Nevertheless, neither Mike nor we were going to take his unwarranted discharge lying down. On Mike's behalf, we asserted some aggressive claims against both Mike's employer and his new superiors, including oppression and tortious interference with contract. Eventually, we were able to negotiate a favorable settlement for Mike, and he wound up with about $3,500,000 (taxed as capital gains) plus the payment of our firm's attorneys' fees.

Mike should have protected himself when he was negotiating his arrangement with his employer, and he should have had an attorney representing him who would appreciate the fine print of the agreement being presented to him. Experienced counsel would have focused on the question of "how can I lose" and could have negotiated provisions to protect Mike in the event of the termination of his employment without cause – especially the acceleration of his stock options so that all, or a healthy portion of them, would vest on firing. Fortunately, Mike learned his lesson. He no longer plays lawyer without legal expertise when it comes to negotiating his employment relationships. Other executives would be wise to heed the lesson that Mike had to learn the hard way.

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