

Severance: Practical Guidance for the Departing Executive

By Brian J. MacDonough & Nancy S. Shilepsky



With rare exceptions, employment relationships are not permanent. Indeed, in many cases, executives and professionals should not expect guaranteed employment for a specific period of time, and should anticipate that their employment may end sooner than expected. Therefore, severance has become an increasingly important component of an executive or professional's overall compensation.

Severance may include base salary, earned but unpaid bonuses, pro rata bonuses for a partial year of service, acceleration of deferred compensation and equity vesting, extended option exercise, health and executive benefits, and executive-level transition services.

The terms of severance are negotiable. However, in exchange, the executive or professional is often asked to affirm or agree to post-employment work restrictions, confidentiality, nondisclosure and nondisparagement covenants, and — almost always — a release of legal claims is required.

If severance was not negotiated prior to or during the employment, it will have to be negotiated by the departing executive or professional. While every departure is unique, the concerns of the parties are relatively consistent. When preparing for such negotiations, consideration should be given to 1) the precedent and practice, 2) post-employment obligations and restrictions, 3) public perception and 4) possible legal claims. We'll examine each of these.

PRECEDENT AND PRACTICE

When negotiating executive and professional severance, precedent and practice matter. Lawyers talk about three types of law — the law of the land, the law of the industry and the law of the shop.

Although they may be enforceable under various theories of law, the latter two are not laws in the conventional sense. Rather, they tend to be followed simply because they embody the principles by which an organization or industry operates. Such information may be obtained from a number of sources, including from regulatory filings, industry-specific compensation studies or simply by asking others.

POST-EMPLOYMENT OBLIGATIONS AND RESTRICTIONS

If an organization has an ongoing need for an executive or professional's services — or even if the organization simply wants the executive or professional to be available as needed during transition — the executive or professional may be able to negotiate post-employment consulting compensation. Likewise, if the organization wants to restrict the executive or professional's professional activities after the departure, provided such restrictions are legally enforceable, additional compensation may take the form of "garden leave" and/or enhanced severance. Even if such restrictions had been obtained prior to or during the employment, such restrictions may be of questionable legal enforcement and an employer may seek to bolster enforceability through severance terms.

PUBLIC PERCEPTION

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In exchange, such organizations may be willing to provide a transition runway (such as more time on payroll in a different position), protection of earned but unpaid compensation (such as forward vesting of equity and deferred compensation), and additional post-employment protections (such as enhanced or accelerated retirement benefits). Transition service providers may be retained to ensure a smooth transition, and communications professionals may be engaged to be sure that the message of that smooth transition is "the story on the street."

POSSIBLE LEGAL CLAIMS

On their own, bad and even unfair employment actions are usually not unlawful. Rather, to be unlawful, the action must be illegal either in motive or in the means by which it is implemented — such as a succession planning decision motivated by unlawful age bias, or a termination implemented in violation of the safeguards provided in an employment agreement. As a general rule, possible legal claims fall into the following four categories:

- Statutory claims include certain whistle-blowing and retaliation claims, discrimination claims, ERISA claims (such as interference with retirement or employee welfare benefits), and claims regarding the nonpayment of wages (as said term is defined under applicable state and federal statutes).
- Contract claims include not just breaches of explicit contract terms, but also breaches of the implied covenant of good faith and fair dealing.
- Claims for equitable include breach of the fiduciary duties that may arise from the nature of certain relationships such as partnerships.
- Tort claims include defamation, tortious interference with advantageous or contractual relations, and intentional infliction of emotional distress.

Needless to say, not all departing executives and professionals have the necessary leverage to obtain or materially improve the terms of severance. However, in almost all circumstances, short of a termination for cause or an organizations' dire financial circumstance, the payment of (or at least the request for) severance is anticipated.

As a practical matter, the departing executive or professional should treat the negotiating of severance as they would the negotiation of any other term of employment — and leverage the circumstances discussed above to obtain the most favorable terms possible. ■

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