3 Problem Issues with Association Executive Employment Contracts

By: Steven John Fellman, Esquire

Congratulations!!! You have just been hired as the new CEO of the Widget Manufacturers Association and you have signed a typical Executive Employment Contract. Your contract provides for an annual review and includes a clause giving the Association the right to fire you without cause. If they fire you without cause, you get 12 months compensation including salary and fringes.

However, unless your contract is written properly, you may not be entitled to what you understood that the association has agreed to give you. Let's look at several issues.

1. *Annual Review*

Every association CEO should get an annual review but the annual review should be based on a written set of performance criteria presented to the CEO at the beginning of the contract year. The annual review should take place at least thirty days prior to the end of the contract year and the review should primarily be based on how the CEO's performance relates to the criteria established at the beginning of the year. In many associations, the culture of the organization is such that the annual review process is not based on objective criteria but is essentially a "popularity contest" that takes place a day or so before the anniversary date of the contract. The members of the Executive Committee meet in Executive Session and ask each other how the CEO is performing. There are no pre-established metrics or objective criteria for measuring performance. Your evaluation is based on whether the Executive committee members "like" you.

In interviewing for a new job, you need to find out how the association conducts its annual CEO evaluation. If it appears that the organization is one following the "popularity contest" tradition, you need to insert language in the contract setting up procedures to be followed in making the annual CEO evaluation. If you are really concerned, add a clause in the contract that provides that if the association does not follow the required annual review procedure, the CEO will get a minimum raise of 5%.

2. *Cancellation Without Cause*

Most Association Executive CEO Contracts have a provision that gives the Association the right to cancel the contract at any time, without cause. Under such a clause, if the association exercises this right, the association is obligated to pay the CEO severance in amount typically equal to six to twelve month's total compensation. The term "total compensation" is defined to include salary at the level when employment is terminated plus benefits at the level when employment is terminated. The salary level is easily determined but the benefits computation is problematic.

Assume that your benefits package includes group medical, group life, group dental, group long term disability and a 401(k) or pension plan. You can easily determine the amount of premium that the employer pays into each insurance program. However, you may find that when your employment is terminated, while you are receiving severance payments, you no longer qualify as an "employee" eligible for insurance coverage under the group insurance plans. If the association offers to pay you the amount formerly paid as premiums in cash, you may find that you can't buy the same level of insurance coverage for cash amount paid to you and that the payments to you are taxable as regular income.

Before you sign your contract, find out whether you are entitled to group insurance coverage if you are fired and are receiving severance payments. See if the policies might cover you if you were considered as an employee/consultant working at home during the severance period.

Now look at the 401(k) plan. In many plans, you need to be an employee on the last day of the plan year in order to be entitled to the matching payment by the employer. Assume that your employer pays a 4% match and your salary is $250,000. If you are fired before the end of the year, the employer could save and you could lose up to $10,000 of tax deferred dollars.

Before you sign your contract, check both the insurance and 401(k) issues. Find out whether payments made to you by the association to enable you to purchase individual insurance coverage would be taxable. Get an estimate of what it would cost you to purchase comparable coverage to the group policies if you had to purchase individual policies. Look at the provisions of the 401(k) program in terms of when the employer must pay the "match." Then you can determine the real value of your severance package. If you need to have leverage in negotiating these issues, consider offering the employer the right to stop paying the "benefits" if you get a new job which provides similar benefits.

3. Releases

Many Association Executive CEO Employment Contracts provide that it order to be entitled to severance payments, the CEO must sign a mutual release using the standard form that the association has developed in similar discharge cases. When representing the association, I favor such clauses. Without such a clause, the CEO may accept the severance payout and then sue the association for wrongful discharge, discrimination, harassment, etc.

By contrast, when representing the CEO, I am happy when the proposed contract does not include a mutual release clause. If such a clause is included in the draft contract, the association CEO is often faces with the choice of taking the severance and giving up a potential cause of action against the association or suing the association but losing the right to immediate severance and possibly to any severance. Not only is this a difficult choice to make at the time of termination but it is hard for the CEO candidate to object to inclusion of a release clause when the contract is being negotiated. Some employers will take that as a sign that the candidate is not a team player and will take the position that removal of such a clause is not a negotiable issue.

Conclusion

When reviewing your Association Executive Employment Contract, take a pragmatic view and ask yourself what will actually happen if you are fired without cause. Go beyond the theory and ask what you can expect in the real world. When your employment is terminated, you will be glad that you made such a realistic analysis before you were hired. If you don't make this type of analysis, you may be faced with a rude awakening on the day you are told that you are being fired.

If you need help revising your Association's Executive Employment Contract, contact Steve Fellman at sfellman@gkglaw.com.