REQUISITE

VIII The C-SUITE Edition

Interview:
Michael D. Eisner

Protecting Your Valuable Business Information and Relationships
by Jennifer Fowler-Hermes

The Importance of CEO and Board Communications for Nonprofits
by Ric Gregoria and James-Allen McPheeters

Equity Incentive Compensation for Management
by Michael J. Wilson

WILLIAMS PARKER
HARRISON DIETZ & GETZEN
ATTORNEYS AT LAW
EST. 1925

Uncertainty is trending. Our C-Suite clients face significant and rapid changes in politics, taxation, regulations, and technology. Some will be helpful and some will not. While we cannot predict the future, our deep experience with topics critical to senior executives provides an advantage in a turbulent environment. Our attorneys help the region's C-Suite leaders navigate their business challenges daily. Whether the issue is strategic (e.g., building the optimal board of directors; designing an equity incentive program for management) or tactical (e.g., protecting trade secrets, designating the proper beneficiary for retirement plan programs), executives in the for-profit and nonprofit settings appreciate practical guidance. We also understand the need to provide legal counsel in settings where the ratio of questions to answers is uncomfortably high.

For this edition of *Requisite*, we asked Michael Eisner (former CEO of The Walt Disney Company and current CEO of Tornante and founder of The Eisner Foundation) to reflect on his career and leadership style. We also address various issues and challenges encountered by business owners and senior executives within the private sector, including large nonprofit organizations, in managing their businesses and the associated risks. We explore board relations and responsibilities, protecting valuable business information and relationships, beneficiary designations, employee equity provisions, and equity incentive compensation for management. Additionally, we are pleased to feature an article on executive employment agreements and compensation plans by our legal colleagues at Varnum LLP, a fellow member of Ally Law, an international alliance of law firms that allows us to provide our clients with legal support across the globe.

In this age of uncertainty, we hope you find our approach useful and informative. Additional resources and digital editions of *Requisite* can be found at williamsparker.com.

Ric Gregoria

Ric Gregoria
President

CONTENTS

WILLIAMS PARKER
HARRISON DIETZ & GETZEN

HIGH RISE

FATHER OF THE SKYSCRAPER

In 1883, William LeBaron Jenney was appointed by the Home Insurance Company in New York to design a tall, fireproof building for its Chicago headquarters. His revolutionary design utilized an inner skeleton of vertical columns and horizontal beams made out of steel. This was in stark contrast to earlier structures, which were supported by heavy masonry walls. Steel was not only lighter than brick, but it could carry more weight. With this new method of construction, lighter masonry walls could be "hung," a bit like curtains, from the steel frame. As a result, the walls of the building didn't have to be as thick, and the structure could be much higher without collapsing under its own weight. Buildings with this type of frame could also have more windows, as the steel frame supported the building's weight and the stone or brick exterior merely acted as a "skin" to protect against weather.

The Home Insurance Building was completed in 1885; it originally had 10 stories and stretched 138 feet into the air. During its construction, city authorities were so worried that the building would topple over that they halted construction for a period of time so that they could ensure its safety. In 1890, two additional floors were added at the top, bringing the total height to 180 feet (55 meters). In addition to being the first of a new generation of steel-framed skyscrapers built in cities across America and the world, the building set the standard for various other building innovations, including rapid, safe elevators, wind bracing, and modern plumbing.

Jenney's achievement paved the way for the work of a group of architects and engineers that would become known as the Chicago School; together, they would develop the modern skyscraper over the last years of the 19th century and the first years of the 20th. Several important members of this group worked at one time in Jenney's office, including Daniel Burnham (who would go on to design New York City's iconic Flatiron Building), John Root, and Louis Sullivan. Though New York would later become known for taking skyscrapers to new heights, Chicago has retained its title as the birthplace of the skyscraper, thanks to Jenney and the rest of the Chicago School. The first of these historic buildings, Jenney's Home Insurance Building, was demolished in 1931 to make way for the Field Building (now known as the LaSalle Bank Building).

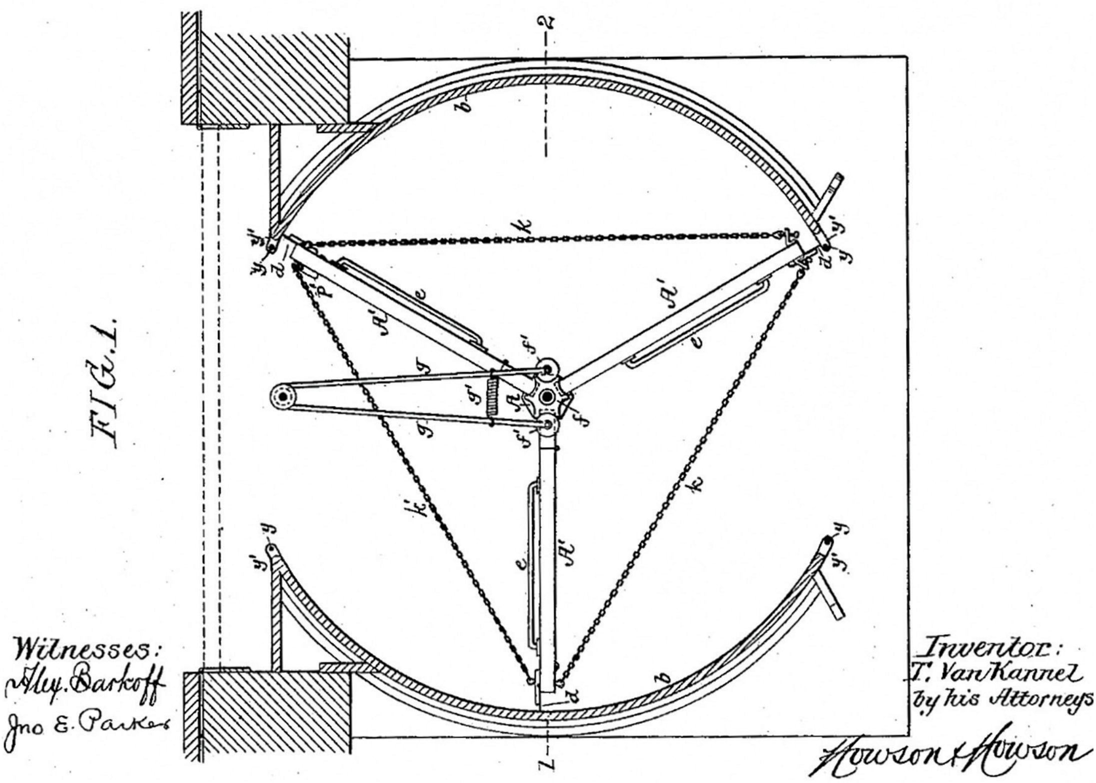
"What is the chief characteristic of the tall office building?
It is lofty. It must be tall.
The force and power of altitude must be in it,
the glory and pride of exaltation must be in it.
It must be every inch a proud and soaring thing,
rising in sheer exaltation that from bottom to top
it is a unit without a single dissenting line."

~ Louis Sullivan

The Tall Office Building Artistically Considered (1896)

REVOLVING DOORS

An old urban legend holds that revolving doors were invented to prevent horses from entering buildings. Although that's funny, it's not true. Theophilus Van Kannel, of Philadelphia, was granted US patent number 387,571 on August 7, 1888, for a "Storm-Door Structure." The patent drawings filed show a three-partition revolving door. The patent describes it as having "three radiating and equidistant wings . . . provided with weather-strips or equivalent means to insure a snug fit." The door "possesses numerous advantages over a hinged-door structure . . . it is perfectly noiseless . . . effectually prevents the entrance of wind, snow, rain or dust . . ." "Moreover, the door cannot be blown open by the wind . . . there is no possibility of collision, and yet persons can pass both in and out at the same time." The patent further lists "the excluding of noises of the street" as another advantage of the revolving door. It goes on to describe how a partition can be hinged so as to open to allow the passage of long objects through the revolving door. The patent itself does not use the term "revolving door."



Theophilus Van Kannel's patent drawing for a revolving door, 1888

Skyscraper design requires some sort of draft block, such as revolving doors, to prevent the chimney effect of the tall structure from sucking in air at high speed at the base and ejecting it through vents in the roof while the building is being heated, or sucking in air through the vents and ejecting it through the doors while being cooled, both effects due to convection. Revolving doors contribute to keeping a building energy-efficient by regulating its temperature and air pressure.

Etiquette suggests it is proper for a man to open doors for a woman, allowing her to enter and exit before he does. But in the case of revolving doors, a man should go first through the revolving doors and assist the woman. This relieves women of the effort of pushing the door open and is ultimately considered a more polite move. Chivalry isn't dead, but it's been updated for modern times. As it turns out, this polite gesture would crush the feelings of the revolving door's creator. It is said that he so disliked the social convention of men opening doors for women that he invented a new type of entrance in an attempt to sidestep the issue. Luckily for Van Kannel, he also had the scientific chops to back it up, even if he was inadvertently creating a new rule in the original one's stead. You may not be surprised to learn that he never married, but rather dedicated himself to improving his creation. He founded the Van Kannel Revolving Door Company, which was bought out by the International Steel Company in 1907. He went on to invent and own *Witching Waves*, an amusement ride introduced at Luna Park, Coney Island.

In 1889, the world's first wooden revolving door was installed at *Rector's*, a restaurant on Times Square in Manhattan, and the Franklin Institute of Philadelphia awarded the John Scott Legacy Medal to Van Kannel for his contribution to society. In 2007, Theophilus Van Kannel was inducted into the National Inventors Hall of Fame for the invention of his "Storm-Door Structure."

Rector's, a restaurant on Times Square in Manhattan
located on Broadway between West 43rd and West 44th Streets

The timing was right for Charles Rector, who had already launched a successful seafood restaurant in Chicago in 1884. He opened a second Rector's in New York City in 1899, a time of big living and high rollers. The Gay Nineties society included financiers, singers, dancers, actors, and gamblers. Their goal was to be seen, and *Rector's* on Broadway, in the heart of the theater district, was the place to do it. Noisy and ostentatious, they streamed through the first revolving door late into the night. The Ziegfield Follies captured the spirit with a hit song, *If the Tables at Rector's Could Talk*.

INTERVIEW

Chief executive officers of corporations large and small inhabit the rarefied air of the decision-maker charged with ultimate responsibility. Their management styles and philosophies shape their companies like few other forces. Pressure abounds. Though every business is the sum of its parts, CEOs know successes and failures will in the end be credited to them.

Michael Eisner understands this better than most. Through the course of his global entertainment industry career, Eisner stamped both Paramount Pictures and The Walt Disney Company with his team-building and forward-thinking CEO management personality. While at Paramount, Eisner made films that would become cultural touchstones, including *Saturday Night Fever*, *Grease*, and the *Star Trek* and *Indiana Jones* franchises. For more than 20 years at Disney, from 1984-2005, Eisner directed the explosive growth of what had been a $1.5 billion film and theme park company into a $31 billion diversified media conglomerate. His tenure included *The Lion King* and *Beauty and the Beast*, international theme park expansion, partnership with Pixar, and acquisition of Miramax, ABC, and ESPN. Today, Eisner continues as CEO of Tornante, which produces content for Netflix, and serves on the board of The Eisner Foundation, a nonprofit focused on disadvantaged seniors and children in Los Angeles.

Eisner visited Sarasota to open the 2016 Ringling College Library Association's Town Hall Lecture Series, underwritten in part by Williams Parker. The firm asked Eisner to reflect on his career, his leadership style, and the trends he sees in the rapidly evolving realms of media and entertainment.

This interview has been edited for clarity.

WP You built Disney into one of the most valuable companies in the world. What are the signature philosophies of your CEO leadership style?

Eisner

My leadership style is mostly cheerleader stuff. I've been too enthusiastic at times. Somebody tells me a good idea, I go over the top, 'Let's do this, come on, let's put on a show.' But you can't just be enthusiastic. Creativity can flourish within sensible financial limitations. Any number of mega-budgeted films have been mega-flops because they attempted to substitute greater capital expenditure for creativity. At Paramount, we kept movie budgets under $10 million, which was well below the industry average. At Disney, I continued this practice of keeping budgets well within the norm. You can't get to perfection, because that would break you financially. But excellence is what's good.

WP Even keeping budgets on a leash, you made culturally significant films like *Grease* and *Roots*. How did you know these would become such huge hits?

Eisner

With *Grease*, we didn't know we had a cultural phenomenon. John Travolta had made *Saturday Night Fever*, he was hot. Then *Grease* exploded and I still hear the songs in my house all the time. With *Roots*, again we had no idea. Most people thought it was going to be a big failure. You can't predict it. You make good things; some of them fool you at how good they are. You simply never know.

WP You have said that a CEO should have a decision-making partner. What have been the benefits of these partnerships for you?

Eisner

There is what I call 'partnership math.' One plus one equals three, or 30, or maybe 300. Two minds that are supportive and challenging of each other can make the difference between an idea that dies a quiet death and an idea that becomes a phenomenon. I benefited from three great partnerships in my life—one with my wife, one with Barry Diller of ABC and Paramount Pictures, and one with Frank Wells at Disney. For 10 years, Frank and I worked side by side. By any objective measure, Disney achieved tremendous growth during this period. But no yardstick can gauge the sheer enjoyment I experienced every day working with Frank. Partnerships make you happier.

WP How is power shared in partnerships when ultimate responsibility remains with the CEO?

Eisner

One individual always assumes the senior role. In my partnership with Barry Diller, it was Barry. At Disney, I had ultimate responsibility. The yin and yang quality of partnerships provides a balanced approach to problem-solving. But it also fosters creative tension, with each partner prodding the other. In every partnership I had, there was an unqualified supporter. If you can pair up with a compatible partner, you'll find that things tend to work out better and you will enjoy the journey that much more.

WP You occasionally took criticism as a micromanager at Disney. Should a CEO not micromanage?

Eisner

Conventional thinking has come to depict micromanagement as a pejorative. Nothing could be further from the truth. Micromanagement is just shorthand for saying that managers should be very involved in every level of operations and should assume a high degree of responsibility for everything. Walt Disney was one of the great micromanagers of all time. Whether he was coming up with a gag for a cartoon or picking trash up off the streets at Disneyland, nothing was too small for his attention. Walt understood that micromanagement is leading by example, being willing to get into the weeds, and if necessary, pull some out with our own hands.

WP Is it better to stay with tested business strategies or to try new things?

Eisner

A combination of the two is a way to go. There's nothing wrong with the past. There's nothing wrong with Broadway shows, there's nothing wrong with movies, there's nothing wrong with theme parks. But there's also nothing wrong with Facebook, Twitter, or Snapchat. If you only stick to the past, you're probably going to atrophy. As they say in *The Lion King*, 'The past is in your rear, so leave it behind you.' But if you only stick with the future, you're probably going to be pretty unlucky and fail.

WP How have you handled failure along the way?

Eisner

As Tom Watson, the builder of IBM, once said, 'The way to accelerate your success is to double your failure rate.' I try to make everyone aware that failure is not a corporate death sentence. Making the same mistake twice is seriously frowned upon, and three times is really bad, but to punish failure is to encourage mediocrity. Mediocrity is what fearful people will always settle for. At Disney, we encouraged failure with something called 'The Gong Show.' We would all sit around the table and toss out ideas for movies or TV shows—outrageous ideas were completely acceptable. Of course most of the ideas were awful and would deservedly get gonged. But some really creative concepts could emerge. *The Little Mermaid* came out of a Gong Show.

WP You now spend much of your time in the nonprofit sphere. Is there a difference between leading a corporation and leading a foundation?

Eisner

(Laughs) Disney has 150,000 people and my foundation has four. Also, whereas everybody thinks that the nonprofits are vanilla and totally without any bumps or warts, that's not true. Not-for-profits have the same issues as for-profits. There isn't the quarter-by-quarter analysis, which sometimes can be very annoying, but they do have a lot of regulatory situations. There are people who are not as good as they should be, people who are irresponsible. But there are also nonprofits that are fantastic and run emotionally and financially for the consumer they serve.

WP What is the most exciting trend in media today?

Eisner

Streaming services are beginning to dominate the marketplace. The big issue is, 'How big does Netflix get?' I know them well because I have a show, *BoJack Horseman*, on Netflix. Since leaving Disney, I started a company called Tornante—'hairpin turn' in Italian—we've released over 20 successful Internet series. But no, TV is not dead. People thought television was going to kill movies, and movies are still alive. Television was going to kill radio, and radio is still alive. Video was going to kill television, and DVDs and Blu-ray were going to kill video. But it does not happen. What happens is one and one adds up to two-point-five. The audience grows bigger; there is more available access to programming. But when that transition happens, the existing media get very nervous.

WP Have we reached a turning point in media distribution?

Eisner

It happens around once a decade: a phenomenon. Wireless distribution has changed entertainment on a technical basis—Netflix, Amazon, Hulu, and so forth. Traditional television where you get used to a show at 9:00 p.m. is now limited to basically sports and news. You can now watch a show anytime, anywhere, whether it's on iTunes, or Netflix, or whatever. The world has changed, for better I think, because it's more competitive for quality programing. But there's also a lot of junk. We always maintain our high level of junk. (Laughs.) But there's also a high level of quality that is finding its way to television.

WP Do you, personally, use social media?

Eisner

Yes. My children are obsessively posting about their children on Instagram. So it's like I live with all of my grandchildren. Texting is fantastic. You can stay in touch with everybody. Social media is extremely important for marketing. Everybody in my industry is agonizing over whether to use Snapchat, Twitter, or whatever. But I don't think it has replaced verbal recommendations on what to watch. People are social animals; they still get together, go to school together, have families. So there is conversation and people are still talking. That's still the most important part of marketing.

Board Members as Supervisors: The Boss's Boss

~ Kimberly P. Walker

Few volunteers join a nonprofit board of directors to supervise or—the unthinkable—to remove the organization's chief executive officer. However, oversight of the CEO, which includes hiring, compensating, supervising, and, when appropriate, retaining or removing the entity's top employee, is the board's and its individual members' legal responsibility. And unlike many tasks, if the board shirks this role, there's no one else to do it.

In addition to hurting the organization and the CEO, the failure to act may also cause you and other board members to question your well-intended volunteer service. Long, stressful meetings. Board division and resignations. Bad press. No good deed goes unpunished. Fortunately, there is a better way.

Why Boards Don't Supervise

As background, it helps to understand why highly skilled, devoted volunteers may overlook or even avoid this responsibility. First, it's awkward. You were invited to join the board when you were just a fan. Now you're a cheerleader. It feels disloyal and even presumptuous to turn around and judge its welcoming leader. Also, you're a volunteer; she's a professional. You're part-time, maybe a couple of hours a month; she dedicates 60 hours a week. While you have experience in another field, she has worked her entire career in this one.

As board members, your weekly or monthly participation is often driven by important dates and agenda items, fundraising, and more fundraising. There may be no action items on the meeting agendas or an events calendar for supervisory duties, other than perhaps an annual evaluation.

Finally, CEOs are not motivated to beg board members for this oversight. Most have suffered through micromanaging, well-meaning past boards. They have been forced to protect their organizations from board members.

While initially it may feel unnatural to you, regular, open, and appropriate supervision that includes communicating with the CEO about what is going great and what isn't, what the CEO needs from the board, and where the CEO may feel the board is overreaching will be far more comfortable than managing a crisis or replacing a CEO.

Creating an Environment Open to Supervision

To overcome the tendency to avoid supervisory duties, board members should look inward. It's your job as a board member to ensure that you comply with a clear delegation of responsibilities. The board should be acting like a board and allowing the CEO to run the daily operations. If you have any questions about an appropriate division of responsibilities, you will find a lot of literature on the roles of board members (mission, vision, strategy, budget approval, hiring, firing, compensation, and supervision of the CEO to ensure that operations are consistent with the organization's mission, vision, strategy, and budget). The board should stay out of operations other than to the extent necessary to assess (and redirect) the CEO's performance and ensure compliance with the organization's big-picture mission, strategy, and budget. If the board is doing its jobs well, and only its jobs, trust will increase, and the environment will foster a healthy and open supervisory relationship.

Planning

Once the board commits to its appropriate role, it can create a plan for effective supervision of the CEO. It is easier to do this before a controversy or crisis strikes. The board, acting through its chair, should candidly discuss the approach, goals, and best practices focus with the CEO. The board should direct the appropriate committee chair to create a list of responsibilities included in the board's supervisory role, such as interviewing/hiring, setting CEO compensation, setting CEO expectations/goals, CEO evaluation, etc. It should ask the committee to assess whether the board members have sufficient tools and information to make informed decisions; ask for a proposed plan to address any gaps; and ask for a timeline, as well as calendar reports to the board. At the committee level, the board should discuss each topic, obtain input from the CEO, and be prepared to lead a discussion of the full board, including relevant information and a proposed process and timeline for obtaining that information.

CEO-related topics should be first introduced to the full board at an all-board executive session. This encourages participation by hesitant members and helps reassure skeptics of the apolitical best practices agenda. After addressing issues during executive session, the resulting plan and timeline should be reported at a board meeting with the CEO and staff present. The board members' and CEO's tone, ease, and focus on best practices should normalize the discussion and ease stress. Regular, transparent inclusion of the board's supervisory responsibilities in discussions should also alleviate fear and remind staff that the board is ultimately responsible for the organization's mission. Note that open discussion of the supervisory role and process does not mean open criticism of the CEO. Board members should take care to restrict constructive feedback only to the necessary audience to avoid undermining the CEO.

This open approach differs from the unfortunately too common approach of limiting CEO-related discussions to one annual evaluation and many whispers in the hallway. The once-a-year approach often results in poorly informed decisions, missed opportunities to rehabilitate a CEO, and the inadvertent promotion of fear and distrust. While buy-in may take time, openly acknowledging the need for information to supervise and openly planning how and when to obtain the information are a good start.

Hiring

Before participating in any stage of hiring, determine what tools you need. Make a plan to obtain the tools and to carry out the search. Follow your plan, revising it as appropriate.

The first step is to ensure that everyone involved in the decision receives an update regarding interviewing and legally protected characteristics and conduct that should not be discussed or considered in employment decisions. Recognize that your board members' prior information may be out of date or inapplicable to your current organization due to size, location, or industry. Bring in an expert if needed. Ask your constituents (donors, employees, affiliates, etc.) for input. At the board and the committee levels, determine the organization's needs and build a consensus regarding the position details and expectations. (After hiring, the board should revisit this issue and obtain the CEO's input regarding expectations and goals.) Consider having a draft offer letter or contract prepared early in the search. There is no need to complete all of the terms, but the process will help guide those responsible for recruiting.

Carefully manage the logistics and ensure that those assigned recruiting roles understand their responsibilities (and perform them). Weigh the costs and benefits of engaging a professional recruiter; understand his or her networks of candidates and fees. Have any proposed agreements reviewed by counsel in advance of signing. Create a timeline and process for receiving applications and responding to applicants. Consider where and how you will advertise the position. Will it be a local, regional, or national search? Reach out to constituents for input and recommendations. Try to build connections during the process, and avoid alienating unsuccessful candidates. Communicate with internal candidates regarding the plan and the impact that a search may have on those candidates. Consider whether the internal candidates will stay with the organization if they are not promoted.

While the board may delegate interviewing and narrowing the pool of candidates—or any other aspect of the process—to a committee, the board retains ultimate responsibility for the hiring decision. Consequently, whenever possible, board members should ensure they have all the information they need to reach a level of comfort with a CEO candidate before the candidate is hired.

Compensation

Before setting or revising CEO compensation, board members need to understand the relevant market and consult reliable data regarding reasonable compensation for similar positions in similar organizations. Board members should understand the basis for and be able to defend compensation decisions with cogent explanations other than, "She's been here a long time" or "We had to pay him more than the number 2 guy." Compensation decisions should be logical and supported by data, not made in a vacuum. Maintain records of your process, data, and analysis. A nonprofit board must be able to provide a clear, concise message to donors or other constituents who have reviewed your publicly available Form 990 filings. Many nonprofits use compensation surveys, the advice of recruiters, and compensation experts to avoid the liability and penalties associated with the payment of compensation determined by the IRS to be unreasonable. While others with an agenda may spin the information and choose not to share relevant information, your supporters are likely to appreciate your reasoning and transparency. For example, "Our CEO performs at the 90th percentile, and according to a well-regarded compensation survey comparing similar organizations, she is paid at only the 60th percentile (a bargain)." Similarly, donors may appreciate that you relied on the advice of a professional compensation consultant with relevant experience.

Supervision and Evaluation

Supervision and evaluation require a comparison of your CEO's performance to the previously established goals and expectations. Before making this assessment, the board should have, in advance, reached a consensus regarding expectations. This is best accomplished with the CEO's input and candid discussion of the anticipated operational details that impact each goal in the coming year. Throughout the year, the board should communicate with the CEO regarding his or her performance vs. the consensus expectations. These discussions may result in revisions to those expectations. At least annually, and before conducting the board's formal evaluation of the CEO, the board should ask the CEO for a self-assessment on each expectation. The board may incorporate into its evaluation process input from its constituents, whether through an evaluation that seeks the input of staff, donors, contractors, and others (such as a 360 Evaluation that seeks feedback from subordinates and supervisors) or some other means of gathering sufficient feedback to truly assess performance. Board members have shared that staff feedback is invaluable and that without it, a board member cannot supervise the CEO. If you are seeking staff input, the manner in which you ask the questions, the CEO's support of the process, the assurance of no retaliation, and the results in the form of feedback to staff will go a long way toward improving trust and future communications. Some organizations evaluate their leaders on a report-card method populated by agreed-upon data-based results and scores. Others prefer a completely subjective approach. While uncomfortable initially, it is far more productive and much less awkward to candidly discuss roles and performance than it is to face the consequences of avoidance (or a perfunctory address). These regular communications and structures will make it less likely that the board will shock the CEO with a sudden determination that it has lost confidence in and needs to replace the current leader. It will also decrease the likelihood that the CEO shocks the board with a resignation to take a better job because she or he wasn't appreciated. How you as a board perform these roles may have a significant impact on your organization and on the professionals who are willing to entrust their careers to even the most well-meaning and highly skilled part-time volunteers. The value of candor, fairness, and respect cannot be underestimated.

Making a Change?

Supporting and retaining the right leader or removing the wrong one is the board's responsibility. If you don't have the information you need to carry out this critical duty, make a plan as a board to obtain it. Assign responsibility for each step. Set a timeline. Obtain the advice of counsel.

The plan should include an analysis of your legal position. Review your agreements, including any offer letters. Obtain an understanding of your legal obligations, risks, and options, including any necessary steps, notices, or cure periods. Review relevant communications, including evaluations and directives, and determine whether additional direction and guidance are appropriate under the circumstances.

Consider whether perceived deficiencies are experience-based ones that may be overcome with support, training, and time, and address each with the big picture in mind. For deficiencies that appear to be character- or personality-based, such as dishonesty or lack of commitment, adopt a more aggressive supervisory approach: provide clear directives and monitor compliance more closely while assessing the gravity of the concern.

Consider at what stage the board should address an issue or concern with the CEO directly. The ideal is early, candid communications, with the understanding that this practice may need to be altered following a cost-benefit analysis of particular issues. Regardless of when the CEO is included in the process, the board should diligently protect the integrity of its confidential board-level discussions. The board should consider having a board confidentiality policy and, at times, individual confidentiality agreements. Any board confronting CEO turnover should put in place a communications plan, focusing on donors, staff, and media inquiries. Even if it is not needed, the process will be helpful in planning.

Before voting on a CEO's removal, the full board should fully discuss the issue and conduct a cost-benefit analysis, considering both the short-term and long-term impact. Ideally, the board will consider the CEO's feedback, which may be offered by designated board members following a meeting with the CEO, a letter from the CEO, or inviting the CEO to address the full board. The decision on removal or retention is a full-board decision that typically requires multipart discussions spread over more than one meeting. However, egregious conduct is more likely to result in an immediate decision. While the board can delegate all or a portion of these duties, it is not recommended that it do so. Further, despite a delegation, the board as a whole remains responsible for the decision.

If the difficult decision is made to remove a CEO, there are many logistical considerations. Timing, announcements, severance, public comments, vacating the office, transitioning donors, and responding to reference checks should all be part of the plan. Each step should be carried out with integrity, sensitivity, and respect for the individual while maintaining a focus on the organization's mission.

It's About the Mission

Board members who learn what the job entails and take a thoughtful, proactive approach are more likely to recruit and retain rock-star CEOs. Board service must focus on the organization's mission.

Kim is counsel at Williams Parker.

She is a labor and employment attorney who focuses on representing employers in employee-related litigation and providing practical, effective risk management advice. She received her JD from the University of Florida College of Law and is certified by the Florida Bar as an expert in labor and employment law.

Protecting Your Valuable Business Information and Relationships

~ Jennifer Fowler-Hermes

When survey after survey of America's workforce confirms that a large majority of employees admit to taking data from their current or former employers without permission, safeguards to protect proprietary and confidential information, including trade secrets, become a priority. We understand that the loss of corporate data can be devastating. We also know that when a former employee or former business owner solicits business contacts or employees, the results can be equally damaging. In today's highly competitive marketplace, it is essential for businesses to have a well-developed plan in place to protect corporate data and business relationships. Such plans should employ several tools, including, but not limited to, appropriate security safeguards, confidentiality policies, and agreements containing restrictive covenants.

Restrictive Covenants in Florida

In Florida, a business can use restrictive covenants to obtain a promise from an employee, independent contractor, officer, agent, or even a seller of an acquired business not to engage in any behavior contrary to its business interests. Certain restrictive covenants protect specific interests. For example, a covenant "not to compete" is generally a promise that the employee, independent contractor, officer, agent, or seller will not be involved, in any capacity, in a competitive business in a certain geographic area for a certain time period. Other restrictive covenants include covenants "not to solicit" the employer's customers, clients, donors, or current employees and covenants "not to disclose" the employer's confidential business information.

Enforcement of restrictive covenants in Florida is governed by statute. The current statute provides that the enforcement of contracts that restrict or bar competition is permitted as long as the restrictions are reasonable in time, area, and line of business. Additionally, the contracts must be in writing and signed by the persons agreeing to the restrictions. To enforce a restrictive covenant, a business must be able to demonstrate that the covenant it seeks to enforce was based on the need to protect a "legitimate business interest(s)" and that the contractual restraint is reasonably necessary to protect such interests. Florida courts deem restrictive covenants not supported by a legitimate business interest to be unenforceable. In determining whether a restrictive covenant is properly supported, Florida courts may not take into consideration the relative hardship the enforcement of a restrictive covenant would have on the person against whom enforcement of the agreement is sought.

A business may demonstrate a legitimate business interest in a variety of ways. It can point to its need to protect trade secrets; valuable, confidential business or professional information that does not otherwise qualify as trade secrets; the existence of substantial relationships with prospective or existing customers, patients, or clients; the need to preserve customer, patient, or client goodwill associated with an ongoing professional or business practice, a specific geographic area, or a specific marketing or trade area; or its provision to the former employee of extraordinary or specialized training.

For a restrictive covenant to be reasonably necessary to support an entity's interests, it must be reasonable with respect to both duration and geography. Florida law specifies particular time frames for different scenarios under which a restrictive covenant will be presumed reasonable. Those time frames are as follow: (1) For restrictive covenants sought to be enforced against a former employee, agent, or independent contractor, a court shall presume reasonable in time any restraint six months or less in duration and shall presume unreasonable any restraint more than two years in duration. (2) When an organization seeks to enforce a restrictive covenant against a seller of all or part of the assets of a business or professional practice, the shares of a corporation, a partnership interest, a limited liability company membership, or an equity interest of any other type in a business or a professional practice, restraints three years or less in duration are presumed reasonable. Restraints exceeding seven years are deemed unreasonable. (3) When trade secrets are involved, courts presume restraints of five years or less as reasonable and restraints over 10 years as unreasonable.

With respect to the geographic parameters of any restraint, Florida does not prohibit or prevent enforcement of nationwide restrictive covenants, as long as the employer can demonstrate that such a restriction is reasonably necessary.

When a business or portion thereof is sold, and the seller had agreements with restrictive covenants in place, the language of restrictive covenants will control the ability of the purchaser to enforce those covenants. Where a restrictive covenant expressly authorizes enforcement by an assignee or successor, courts may not refuse to enforce that covenant on the grounds that the party seeking enforcement was not an original party. In contrast, an express statement that the restrictive covenant is enforceable by an assignee or successor is unnecessary in a stock purchase.

Although Florida accommodates the enforcement of non-compete agreements, in May 2016, the White House officially encouraged states to ban the unbridled use and enforcement of non-compete agreements against low-wage earners and those who do not have access to employer trade secrets. The White House opined that limiting the use of non-competes would make for a more competitive marketplace and increased wages. The White House statements impose no binding legal obligation on employers, and it remains to be seen whether the new administration will adhere to the same position.

Florida's Uniform Trade Secrets Act

An independent statutory provision that more specifically protects against the misappropriation of trade secrets is Florida's Uniform Trade Secrets Act (UTSA). Florida's UTSA does not require an agreement in order to obtain relief. Florida's UTSA defines a trade secret as information, including a formula, pattern, compilation, program, device, method, technique, or process, that (1) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy. A key provision in this definition is whether the information is not "readily ascertainable" or, stated otherwise, whether the information is not available from public sources or may not otherwise be reconstructed without reference to the business's information. In addition, a business seeking to obtain relief under Florida's UTSA must be able to show that it took reasonable efforts to maintain the secrecy of its trade secrets. Clearly, if a business does not take appropriate precautions to protect its secrets, obtaining relief under UTSA will be unlikely.

UTSA prohibits misappropriation of trade secrets and defines misappropriation in terms of two distinct causes of action: either the acquisition of a trade secret by improper means or the disclosure or use of a trade secret without consent of the owner by someone who used improper means to acquire the trade secret or knew, or should have known, that it was improperly acquired. Unlawful misappropriation also occurs where, at the time of the disclosure or use of the trade secret, the individual knew or had reason to know that her or his knowledge of the trade secret was (1) derived from or through a person who had utilized improper means to acquire it, (2) acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use, (3) derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use, or (4) before a material change of her or his position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.

Trade Secrets Under Federal Law

Until recently, Florida businesses and nonprofit organizations had to rely on state laws to seek legal recourse, including injunctive relief, when an employee or competitor misappropriated trade secrets. This changed in May 2016 when the Defend Trade Secrets Act of 2016 (DTSA) was signed into law. The DTSA creates a federal civil remedy for the misappropriation of trade secrets. This statute was enacted in response to the divergence of protections provided by the states' trade secret laws and to provide additional protection against international trade secret misappropriation. Aside from its whistleblower immunity protections, the DTSA does not preempt state trade secret laws. As a consequence, Florida businesses may now seek civil remedies under both state and federal statutes, and, if claims under state and federal law are brought in one suit, such claims may be brought in either state or federal court.

Similar to Florida's UTSA, the DTSA provides a civil legal remedy for businesses whose trade secrets have been misappropriated. But, while minor differences between the DTSA and Florida's UTSA do not foreshadow much divergence in the civil prosecution of such claims, there are several notable provisions in the DTSA for which there is no similar counterpart in Florida's UTSA. First, the DTSA includes a civil seizure provision, which allows injured trade secret owners to request a court order for the seizure of physical property in the possession of the alleged misappropriator, without notice. This civil seizure remedy is available only in extraordinary cases and is intended to prevent the dissemination or use of the trade secrets. Second, the DTSA's whistleblower provision provides immunity to whistleblowers who divulge a business's trade secrets to attorneys and government officials in the process of reporting illicit activity or in asserting a retaliation claim. Fortunately, this protection only extends to the disclosure of trade secrets that are relevant to the alleged illicit activity—and even then, to qualify for protection, the disclosure must be made under seal.

Finally, the DTSA requires businesses to notify their employees of the law's whistleblowing protections, including the immunity provisions. Failure to provide this notice will limit the statutory remedies available to businesses that successfully prove a misappropriation. Furthermore, businesses that violate the retaliation provision of the DTSA are not able to recover certain damages or attorney's fees, even when a willful and malicious misappropriation of a trade secret or a bad faith claim of misappropriation is established. Accordingly, if a business wants to ensure that it can use this statute as a tool to protect its trade secrets, it should consider updating its employee handbook and including crossreferences to the DTSA in any new or existing employment agreements. Businesses will have to balance concerns that providing specific, written exceptions to confidentiality may encourage misappropriation with the desire to use the DTSA's enforcement mechanisms.

Given the DTSA's recent passage, few courts have been presented with the opportunity to apply and interpret the statute. Therefore, the effect of the statute and, in particular, its extraordinary civil seizure provision, remain to be seen. Regardless, businesses should take the statute's provisions into account when drafting or revising their employee handbooks and employment agreements.

Best Practices for Protecting Information and Business Relationships

When appropriately implemented, carefully drafted, and narrowly tailored, restrictive covenants can effectively protect an employer's legitimate business interests, such as trade secrets, confidential and proprietary information, and substantial customer relationships. While the use of an employment agreement that includes restrictive covenants or a stand-alone non-compete or non-disclosure agreement may not be appropriate for every employee, it is one tool that is useful in mitigating the potential damage caused if an employee leaves your employment to work for a competing business or if a former business owner starts a competing business.

Businesses should also have controls in place to protect their trade secrets and to ensure that departing employees, agents, or independent contractors do not take trade secrets with them. Although written agreements are not required for the protection of trade secrets, they can be of great use in defining the rights of the parties and in providing notice of restrictive covenants to subsequent employers. Additionally, businesses should keep in mind that other businesses are also interested in protecting their information and business relationships, and should evaluate and appropriately adjust their hiring procedures (especially with respect to executive-level employees) to eliminate the risk that a new employee will expose the business to liability for trade secret misappropriation. The best way for a business to protect its valuable information and business relationships is to recognize potential risks and take affirmative steps to protect against those risks.

The assistance of Lindsey Dunn, Esq, in the preparation of this article is most gratefully acknowledged.

Jennifer is counsel at Williams Parker.

She is a labor and employment attorney who focuses on helping private, public, for-profit, and not-for-profit employers in a wide range of matters, including litigation and managing risks to avoid litigation. She earned her JD from the University of Florida College of Law and is certified by the Florida Bar as an expert in labor and employment law.

The Importance of CEO and Board Communications for Nonprofits

~ Ric Gregoria and James-Allen McPheeters

This past fall, Williams Parker hosted a half-day seminar for over 75 leaders of nonprofit organizations in our community. The seminar, entitled “Nonprofit Matters Forum: Management Challenges Facing Nonprofit Leaders,” included talks by Kathryn Miree, a nationally recognized philanthropic advisory consultant; breakout sessions exploring current issues facing nonprofits; and a roundtable discussion among local nonprofit executives. The nonprofit forum focused on how to build an effective, dynamic, engaged board; the keys to success in order to survive and thrive in a challenging nonprofit environment; and the top issues and challenges faced by nonprofits. Two consistent themes emerged: first, that clear and regular communication between the nonprofit’s board and its chief executive officer is critical to the success of a nonprofit, and second, that a nonprofit’s board and its chief executive officer must understand what they are doing and why they are doing it.

In a prior *Requisite* article, “Want to Join a Nonprofit Board and Have a Rewarding Experience? Increase Your Odds with Due Diligence,” Michael J. Wilson of Williams Parker wrote about issues a prospective board member should consider before joining the board of a nonprofit. That article explored, among other things, how the size and structure of a board can affect a board member’s experience, due diligence regarding a nonprofit’s finances, and the basic legal obligations of a nonprofit board member. Having participated in the nonprofit forum, and with Mike’s article in mind, we were struck by a simple reality—that to ensure quality communications between stakeholders in a nonprofit and for those stakeholders to understand what they are doing and why they are doing it, there must be a thoughtful and robust relationship between a nonprofit’s board and its chief executive officer. Undoubtedly, there are many aspects to such a relationship. The focus of this article is of the high-level variety: understanding the basic structure of a nonprofit organization, who are the key individuals in a nonprofit organization, and insights into the interactions between a nonprofit’s board and its chief executive officer, which are critical to the success of an organization.

Nonprofits are top-down organizations wherein a discrete group (the board) is responsible for interpreting the nonprofit's governing documents and, in so doing, guiding the mission of the organization. In contrast to for-profit endeavors, however, a key distinction with the majority of nonprofits is that the board members guiding the organization are not shareholders or executives in the organization, with long-term institutional knowledge; rather, they are volunteers who serve a finite term governing the organization. In practice, this means that unlike for-profit endeavors where an individual may simultaneously be an employee, board member, and owner of a company, the majority of nonprofit board members, by their nature, do not have the same long-term, institutional knowledge as does the nonprofit's chief executive officer who, typically, has been with the organization for an extended period of time. While providing finite terms for board members can be a positive way of continually introducing new perspectives and new ideas to an organization, it is important to keep in mind that no matter the recency or duration of a board member's involvement with a nonprofit, by law, board members as a whole are charged with the direction and management of the affairs of the organization.

As Mike Wilson addresses in more detail in the previously mentioned article, the obligation to direct and manage the affairs of the organization takes the form of certain legal obligations that board members owe to the organization. Among them is a board member's obligation to make decisions in good faith with the level of care that an ordinarily prudent person in a like position would exercise under similar circumstances. Because the law provides that a board member may rely on the officers and employees of an organization in discharging this duty, the communication and balance of the relationship between a nonprofit's board and its chief executive officer are of great importance—not only in the board member and the chief executive officer working together to help the nonprofit articulate a strategy for the organization that best fulfills its mission, but also in a board member fulfilling his or her legal obligations.

In order to bridge the knowledge gap that often occurs as a result of board term limits and board member turnover, some nonprofit boards will have the chief executive officer serve as a member of the board, while others often have the chief executive officer participate in board meetings solely by invitation of the board. In most nonprofits, the chief executive officer does not serve as an active or voting member of the board, which helps avoid conflicts and allows the board to act independently of management in the fulfillment of its role. While having a chief executive officer serve as a board member in a nonprofit can have its benefits in offering a greater bank of institutional knowledge and fostering clear communications, these benefits must be carefully weighed against the murkiness the chief executive officer's board membership creates in defining the role of the chief executive officer, in defining the role of the board, and in preserving the appropriate level of board independence. This can be a polarizing issue among leading nonprofit experts, as some are adamantly against a chief executive officer acting as a board member while others are strong proponents of a chief executive officer acting as a nonvoting member of a nonprofit's board. Because each nonprofit organization is unique, this issue must be thoroughly addressed on an organization-by-organization basis.

Though the scope of a chief executive officer's role varies by nonprofit, there are fundamental aspects that ensure a proper dynamic between the board, in its role of directing and managing the affairs of the organization, and the chief executive officer, in implementing the directives of the board and managing the day-to-day operations of the organization. Among these fundamental aspects are the following: (1) that board members are respectful of each other and the chief executive officer, and vice versa; (2) that there is complete candor between the board and the chief executive officer; (3) that board members and the chief executive officer appreciate and solicit each other's ideas on a regular basis; (4) that board members and the chief executive officer share the philosophy and values of the organization; and (5) that board members and the chief executive officer advance the philosophy and values of the organization, not their own agendas.

Though these are basic tenets for any relationship, these concepts, as well as the legal obligations that board members owe to the organization, illustrate that the relationship between a nonprofit's board and its chief executive officer must be a supportive series of checks and balances. When present, these tenets, as well as an adherence of board members to their legal obligations, will allow the board to craft a strategy to advance the organization and its mission, and provide clarity to the chief executive officer to implement that strategy and execute the mission of the organization. The inherent tension in any system of checks and balances—especially one of a nonprofit where board members roll on and off a board, while a chief executive officer (who serves at the pleasure of the board) attempts to implement the board's strategy for the organization—in the best of circumstances creates a structure that allows for and fosters creativity in advancing an organization's mission. Such advancement must be strategic in nature, based on knowledge of the organization and rooted in a thoughtful and robust relationship between an organization's board chair and its chief executive officer.

The importance of the relationship between a board chair and an organization's chief executive officer cannot be overstated. As a starting point, the board chair must not only adhere to the tenets outlined above, but she or he must also focus intently on developing a working relationship with the chief executive officer. Such a relationship must be based on a clear understanding of what the organization's mission is, what the strategy is to implement that mission, and what the chair, on behalf of the board, and the chief executive officer are doing separately and together to advance that mission. The development of this sort of relationship is not borne by simply attending a monthly or quarterly board meeting. Rather, to form and maintain such a relationship, a board chair and an organization's chief executive officer should meet on a regular basis (scheduled or nonscheduled) to discuss issues affecting the organization and the board. These discussions necessarily need to cover the health of the organization—how it is meeting its mission in the community—but should also contemplate the health of the board—how the board continues to develop and improve its management of the organization.

An often overlooked aspect of most nonprofits is the succession plan for the board and the organization's employees, i.e., who will lead the organization in the future and how best to integrate those individuals into the organization. Regardless of how well an organization communicates and the checks and balances it implements to help ensure that the stated mission is fully and properly carried out, it is vitally important that a nonprofit select the right board members and chief executive officer, and that it has a clear succession plan in place. In order to help select a person who has the proper attributes to serve as a board member or a chief executive officer, you will find it helpful for your nonprofit to have a detailed, written description of such attributes created by the board. This description should be carefully and thoughtfully created and reviewed for propriety, and revised, as appropriate, on at least an annual basis. Properly created, this will serve as a filter that helps to ensure the right people are selected for both interviewing and hiring, which in turn helps to secure the success of the organization and its members. Once board members and employees are selected, it is equally critical to have an established orientation program in place, one that educates the new chief executive officer or board member about the organization, its goals, values, and mission. In fact, some organizations find this to be so important that they mandate that every board member and its chief executive officer read the organization's mission statement each year and affirm both their understanding and "buy-in" of the organization's mission.

The relationship between a board and a chief executive officer needs to be viewed in light of a clearly articulated mission and plan for the organization. By understanding the basic structure of a nonprofit organization, the relationship between a nonprofit's board and its chief executive officer, and by developing and maintaining regular and thoughtful quality communications between a nonprofit's board and a nonprofit's chief executive officer, a nonprofit is in the best position to know what it is doing, why it is doing it, and how to meet its mission in a challenging and ever-changing nonprofit environment.

Ric is a Williams Parker shareholder.
He focuses his practice on counseling high net worth individuals, families, and business owners regarding complex intergenerational wealth transfers and business succession matters. He is certified by the Florida Bar as an expert in wills, trusts, and estates. He earned his JD from the University of Virginia.

James-Allen is an associate with Williams Parker.
He focuses his practice on representing clients in general business matters, mergers and acquisitions, asset structuring, and insolvency issues. He earned his JD from Stetson University College of Law.

Equity Incentive Compensation for Management

~ Michael J. Wilson

Privately held businesses provide equity incentive compensation to their management teams for many reasons. According to a February 2014 survey by WorldatWork and Vivient Consulting, the most common reasons are for management retention and recruiting, and to align management incentives with the long-term goals of the business. Here we will explain some of the primary characteristics, including tax impacts, of the most common equity incentive compensation methods used by privately held businesses for their management teams. These methods are also commonly used for directors of corporations or managers of limited liability companies.

The equity incentive compensation methods discussed in this article are restricted shares or units, profits interests, phantom equity or interests (also known as "synthetic equity"), and non-qualified options. Each of these methods has its own advantages and disadvantages, and there is no one-size-fits-all solution. You should give careful consideration and analysis to each before selecting any method and understand that not all methods are available to all businesses under the tax code. Moreover, none of the methods is exclusive—sometimes businesses may use more than one method and sometimes they may combine methods for the same employee. This overview assumes that the company providing the equity incentive compensation is, like most privately held companies, taxed as either a partnership or an S corporation for federal income tax purposes, not as a C corporation.

Restricted Shares or Units

Restricted shares, in the case of a corporation, and restricted units (or a capital interest), in the case of a limited liability company or partnership, involve the granting of an equity interest that is subject to certain restrictions. These restrictions typically relate to vesting, transferability, and forfeiture. For example, an equity award might vest ratably over a certain number of years, and vesting might accelerate upon a change of control. If one of your employees quits, then he or she would typically forfeit any unvested shares or units and would either be able to retain or be forced to sell his or her vested shares or units. If you terminate an employee for cause or for breaching a post-employment covenant, such as a non-compete or non-solicitation provision, both vested and unvested shares or units might be forfeited.

A major obstacle in granting restricted shares or units is the tax impact to the employee. In general, the fair market value of the restricted shares or units granted to your employee or other person as compensation for services is taxable to the employee as ordinary income when the shares or units become "substantially vested," which generally means the shares or units are either transferable or not subject to a substantial risk of forfeiture. At that time, the value of the shares or units, and thus the tax impact to the employee, could be very large.

If the value of the restricted shares or units is relatively low at the time of grant, the employee may want to consider making a so-called "section 83(b) election" to have the value of the shares or units taxable as of the grant date, instead of at the later date when the shares or units become substantially vested and potentially have a much greater value. The appreciation in the value of the shares or units after the grant date would be taxable as capital gain upon a sale or other realization event, but the employee generally cannot claim a deduction for any loss in value after the grant date. The employee would not be eligible for a tax loss if he or she forfeited the shares or units prior to vesting. Consequently, the employee must carefully weigh the tax impact of making a section 83(b) election to accelerate the gain recognition at the time of grant against not being able to take a tax loss if the unvested shares or units are later forfeited.

Your company may claim a compensation deduction at the time the employee recognizes compensation income from the grant of the shares or units. The company does not receive a deduction for the amount taxed to the employee as capital gain.

One structure that is sometimes used to mitigate the tax impact of granting restricted shares or units is for your employee to purchase the ownership interest at its fair market value in exchange for a promissory note with a modest amount of cash paid upfront. By structuring the acquisition of the ownership interest as a purchase instead of it being granted in exchange for services, the employee is not taxed upon the receipt of the interest. In these circumstances, the promissory notes often have a relatively long term and a low interest rate, and they provide for annual, interest-only payments with a balloon at maturity. Often, these notes would be repaid using cash or a portion of the cash that would otherwise be distributed to the employee. However, you must give careful consideration when structuring these transactions to increase the likelihood that the IRS will respect the transaction as a true purchase of the ownership interest. This structure is more commonly used by S corporations because, as explained below, they cannot grant profits interests.

Profits Interests

Profits interests are an extremely popular method for limited liability companies taxed as partnerships and state law partnerships to provide equity incentive compensation to management and other employees. While a regular ownership interest (known as a capital interest) entitles the holder to a share of the current assets and future profits and appreciation, a profits interest entitles the holder only to a share of future profits and appreciation. The special distribution rights limiting the holder of a profits interest to only future profits and appreciation are normally described in the operating agreement or partnership agreement of the issuing entity.

Because a profits interest only provides for the right to future profits and appreciation, the grant of the interest is generally not taxable to the employee at the time of receipt or at vesting. More precisely, the grant of a profits interest is generally not taxable to the employee at grant if (1) the profits interest is not related to a substantially certain and predictable stream of income, (2) the profits interest is not sold within two years of grant, and (3) the company is not publicly traded. The grant of a profits interest is not deductible by the business.

Before a holder of a profits interest is entitled to any distributions, the pre-existing owners must first receive cumulative distributions at least equal to the fair market value of the business immediately prior to the grant of the profits interest. It is helpful to look at an example that illustrates the mechanics of the distribution rights of a profits interest. If a limited liability company has three members, with members A and B each owning 40 percent and each having contributed $250,000 in cash to the business, and if the business granted a 20 percent ownership interest to C in exchange for services at a time when the fair market value of the business was $1,000,000, then after the grant to C, members A and B would be entitled to receive the first $1,000,000 of distributions made by the business (sometimes referred to as a "hurdle amount" or "participation threshold"), and every dollar distributed after that $1,000,000 would be distributed to the members in proportion to their ownership interests: 40 percent to A, 40 percent to B, and 20 percent to C.

The example above assumed that once the $1,000,000 participation threshold was achieved, A, B, and C would share distributions in proportion to their ownership interests. However, sometimes businesses want to provide profits interest holders with economics that are closer to a regular ownership interest (or capital interest). To achieve this goal, the operating agreement could provide that once the participation threshold is satisfied, special distributions (sometimes referred to as "catch-up" or "fill-up" distributions) would be made only to the profits interest holders to catch them up to the distribution amount they would have received if they were entitled to receive their proportionate share of the participation threshold. For example, if the limited liability company in our previous example was going to make a distribution of $1,300,000 and a catch-up allocation was used for C, then the first $1,000,000 (the participation threshold) would be distributed: $500,000 to A and $500,000 to B. Then the next $250,000 would be distributed solely to C, and the remaining $50,000 would be distributed to A, B, and C in proportion to their ownership interests—40 percent to A, 40 percent to B, and 20 percent to C. This distribution scheme results in C receiving the same amount of cash ($260,000) as if C had participated in the entire $1,300,000 distribution at C's 20 percent ownership interest. Therefore, if the business generates sufficient profits, the profits interest holder can realize the same economic value as the holder of a capital interest.

The tax advantage of a profits interest is that the grant of the interest is generally not taxable to the employee at the time of receipt. If, in the example above, the company granted member C a regular 20 percent ownership interest (assuming the interest was substantially vested), then, ignoring any applicable valuation discounts, the $200,000 of value (20 percent of the $1,000,000 fair market value of the business) granted to C would be treated the same as if the company paid C $200,000 in cash. This means that C would be subject to ordinary income tax and self-employment tax on the $200,000 even though C did not receive any cash at the time of the grant. C would generally not be happy with a large tax bill and no cash.

All ownership interests in an S corporation are required by applicable tax law to have the same distribution and liquidation rights. Consequently, S corporations cannot issue profits interests.

Phantom Equity

Phantom or synthetic equity is not truly an ownership interest in the business. Instead, it is a contract between the business and the employee designed to mimic all or part of the economics of having a true equity interest in the business. Phantom equity arrangements are usually structured by granting the employee a certain number of “award units” that mirror the value of a true ownership unit in the business. Payments made under the phantom equity agreement can be triggered by various events, including a sale of the company or upon termination of employment without cause. Like true equity, phantom equity can also be subject to a vesting schedule so that employees receive the benefit over time instead of all at once.

Because phantom equity is not true equity, it does not have voting rights and does not give the holder statutory inspection rights of the business’s book and records. Furthermore, the majority owners, officers, and manager/directors of the business do not owe fiduciary duties to phantom equity holders as they do to holders of true equity interests.

Phantom equity arrangements are not taxable upon receipt or vesting. Employees are taxed when they receive payment pursuant to the phantom equity arrangement. Such payments are treated just like any other cash compensation paid to employees, so the payments are ordinary income to the employees (reported on the employees’ W-2s), deductible by the company, and subject to payroll and withholding taxes.

In our experience, phantom equity is more commonly used by S corporations, rather than by tax partnerships, to provide equity incentive to their management. This is primarily because S corporations cannot issue profits interests under applicable tax law and because of a general desire to avoid the potential negative tax implications of granting restricted shares or units.

Options

While stock options are commonly used by public companies, over the past decade, stock and other options to acquire equity have become much less frequently used by privately held businesses. One reason for their prevalence in public companies is that the public company employee has a ready market to sell some of the stock upon exercise to pay the resulting tax. The reason options are not common for privately held businesses is that, for tax reasons, the exercise price is generally equal to the fair market value of the underlying equity on the date the option is granted. This often means that employees have to pay a large sum to exercise the option, which can significantly limit their incentive and economic benefit.

Generally, an employee is not taxed on the receipt or vesting of an option to acquire stock or other ownership interest in a privately held business. However, when the option is exercised, the employee recognizes ordinary compensation income on the excess of the fair market value of the stock or other ownership interest on the exercise date over the exercise price. Any appreciation in the value of the stock or ownership interest after the exercise date is generally taxed as capital gain.

The business is entitled to a deduction at the time of exercise (i.e., when the employee is taxed) equal to the amount taxable to the employee. The business does not get a deduction for any amount taxed to the employee as capital gain.

Summary

In our experience, businesses taxed as partnerships (most limited liability companies and state law partnerships) that anticipate having significant capital gain upon a future sale generally prefer a profits interest as their method of providing equity incentive compensation to management. One primary reason for this is that a profits interest permits capital gain treatment to the employee. On the other hand, where significant capital gain is not anticipated and the business wants simplicity in its ownership structure and agreements, then phantom equity is typically the best method. Because businesses taxed as S corporations cannot issue profits interests, phantom equity is often the best method for them to provide equity incentive compensation to their management team.

Mike is a Williams Parker shareholder.

He practices tax, corporate, and business law, handling sophisticated tax planning and tax controversy matters and advising clients on their most significant business transactions. He is an active member of many civic and legal organizations' boards. Mike earned his JD and MAcc from the University of Florida and he is certified by the Florida Bar as an expert in tax.

Employee Equity Provisions in Organizational Documents

~ Zachary B. Buffington

Most successful privately held businesses understand and appreciate the value of talented individuals. As a result, the owners and executives of those organizations recognize the need to attract, retain, and incentivize high-quality employees. One way to do this is to issue or grant an equity interest in the organization. While providing an equity interest to key individuals can serve as an effective short-term and long-term business strategy, owners and executives also need to look at the change in ownership from a legal perspective. Together with designing the appropriate form of equity to be issued or granted to its employees, the organization should dust off its governing documents (operating agreement, partnership agreement, shareholders agreement, bylaws, and similar documentation) and consider what amendments and updates are necessary.

As owners and executives, you must think through numerous topics and potential pitfalls when you review the governing documents in connection with plans to add a new employee-owner. You may find that certain areas require modifications, and you may need to add new provisions. For example, it is important for the organizational documents to define the employee-owner's rights to receive dividends or distributions and to specify any limitations on the employee's voting rights and authority. You can often establish different dividend and distribution rights, as well as different voting rights, among owners, where tax laws permit, by having more than one class of shares or units. The governing documents also should address whether the employee-owner will be required to participate in capital calls and, as a result, be required to contribute funds along with the other owners to help the organization pursue new investments or pay off liabilities. Non-competition obligations, non-solicitation obligations, and other restrictive covenants may be appropriate, depending on the nature of the services the employee provides, the market and industry in which the business operates, and other factors. In addition, the governing documents should include necessary securities representations and warranties by the employee.

The preceding paragraph touches on only some of the employee-equity provisions frequently included in the governing documents of a privately held business, and there are many other topics that should be discussed. The purpose of this article is to focus on two of the most fundamental topics an organization should consider when it provides an equity interest to an employee: (1) restrictions and limitations on the ability of the employee-owner to transfer his or her equity interest, and (2) buy-sell rights with respect to the employee's equity interest, which arise upon the occurrence of certain significant events.

Restrictions on Transferability of Equity Interest

In your role of business owner and executive, when you decide to issue or grant an equity interest to an employee, your intent is for that particular individual to be an owner of the organization. You generally do not intend for a third party or outsider to somehow acquire the equity interest at a later date. To prevent a transfer of shares or units against the intent of your organization, you should ensure that the governing documents include reasonable restrictions and limitations on the ability of an employee-owner to sell or transfer his or her equity interest.

Many organizations include right of first refusal provisions in their governing documents to help protect against an unwanted sale or transfer. Typically, a right of first refusal gives the organization the option, but not the obligation, to purchase the employee-owner's shares or units before he or she may sell to a third party. The employee-owner is prohibited from selling to a prospective buyer unless and until the opportunity to purchase the equity interest, for the same purchase price and on the same terms, is first offered to the organization.

Similarly, organizations want to prevent creditors of an employee-owner from acquiring any type of ownership interest in the business. Therefore, the governing documents should make clear that the employee has no right to pledge his or her equity interest as collateral and no right to subject his or her shares or units to a lien, mortgage, or security interest. Under a properly drafted governing document, any pledge or encumbrance in violation of this prohibition would trigger a right of the organization to purchase the employee's shares or units (as discussed below).

Buy-Sell Provisions Applicable to Equity Interest

As with restrictions on the transferability of an employee's equity interest, buy-sell provisions also are a fundamental part of your organization's governing documents. Buy-sell provisions help to anticipate and plan for certain significant events and to ensure the preservation and continuity of the organization following the occurrence of those events. The significant events (often referred to as "triggering events") can include the death or disability of the employee; the bankruptcy of the employee; a prohibited sale, transfer, or pledge of the employee's shares or units; the retirement of the employee or his or her termination of employment with the organization; and other events that would cause the business to reconsider the equity arrangement with the employee. Moreover, a sale of substantially all of the organization's assets or a sale of a majority ownership interest in the organization could trigger buy-sell rights and obligations (Governing documents also commonly include "drag-along" rights, which enable the majority owners to require the minority owners to participate in an equity transaction, and "tag-along" rights, which enable the minority owners to join with the majority owners and participate in a transaction.)

As a general description, the buy-sell provisions in governing documents give your business entity the option to purchase the equity interest of an employee-owner in the event one of the specified triggering events occurs. (The parties could agree to make the purchase mandatory rather than give the organization the option.) The buy-sell provisions also establish preset terms and guidelines to govern how such a purchase will be carried out. Most importantly, the method for determining the purchase price, as well as the manner and timing in which the purchase price will be paid, should be agreed to in advance in the governing documents. Although buy-sell provisions typically appear similar from one business to the next, the mechanics and details will vary based on the preferences of the organization, the number of owners involved, and the circumstances that trigger the purchase option (or purchase obligation).

It is critical for you as owner and executive to accurately and clearly define what constitutes a "triggering event." Some events, such as the death or the retirement of an employee, are clear. However, other events, particularly the "disability" of an employee and "for cause" termination of his or her employment, require a more detailed definition to avoid disputes among the parties as to whether or not the buy-sell provisions are triggered. For example, one approach to defining "disability" in the governing documents is to tie the definition to the organization's disability insurance policy. In defining "for cause" termination, the governing documents should conform to the employee-owner's employment agreement so the definitions are consistent. If the employee does not have a written employment agreement with the organization, the buy-sell provisions in the governing documents should include a clear and comprehensive definition of "for cause" termination.

As mentioned above, the organizational documents should articulate how the purchase price for any purchase under the buy-sell provisions will be determined. There are several methods to establish the value of the employee's equity interest. One method is to specify the formula that will be used to calculate the value. Asset-based valuation formulas, income-based valuation formulas (such as a capitalization approach or discounted cash flow approach), and revenue-based valuation formulas (such as an EBITDA multiple approach) are formulas that privately held businesses often use. The chosen formula, of course, will depend on many factors, including the particular industry, the nature and size of the organization, and the preferences of the business owners. A second common method is to use a qualified appraiser. Under this method, the governing documents should establish a procedure for the selection of an appraiser mutually acceptable to the organization and the employee-owner. The appraiser then would determine the value of the equity interest to be sold and purchased. A third method is to periodically specify the value of the business by a written agreement of all the owners. If this method is used, an appraiser or other valuation advisor should make the determination of value on a regular basis—preferably annually or semiannually.

In addition to describing how the price for any purchase under the buy-sell provisions will be determined, your organization's governing documents also should set forth the terms and timing of the purchase. Many privately held businesses do not have excess cash available to fund a buyout of an employee-owner's shares or units. Accordingly, it is important for the organizational documents to give the business the ability to pay the purchase price over a period of time rather than pay the full amount at closing. Businesses often prefer having the option to pay 10 percent to 25 percent at closing, with the balance to be paid over a specified period, such as five to ten years. The terms and timing of the purchase could differ depending on the triggering event that results in the purchase. If the purchase option is triggered due to the “fault” of the employee-owner (for example, if the employee-owner’s employment was terminated “for cause” or if the employee-owner attempted to transfer, sell, or pledge his or her equity interest in violation of the governing documents), the buy-sell provisions could include purchase terms more favorable for the organization. Under such circumstances, it may be appropriate to permit the organization to pay a lower percentage of the purchase price at closing or to pay the purchase price over a longer term of installments.

Conclusion

Providing an equity interest to a key employee certainly can be advantageous for a privately held business. When doing so, along with evaluating the appropriate form of equity to be issued or granted, an organization must carefully review and analyze all of the dynamics involved with the addition of a new employee-owner. Thoughtful, well-crafted governing documents will help the employee understand his or her rights and responsibilities, help the organization plan for future events, and help all parties avoid some of the headaches and disputes often associated with employee-equity arrangements.

Zach is an associate with Williams Parker.

He focuses his practice in the areas of business law and health law. He represents business owners and executives in connection with acquisitions, sales, mergers, joint ventures, and investments, as well as corporate governance and operational matters. Zach earned his JD and MBA from Stetson University.

Executive Employment Agreements and Compensation Plans: Avoiding the Deferred Compensation and Golden Parachute Tax Traps

~ John Arendshorst and Katherine Wilbur

A well-crafted employment agreement can be of great benefit to both the company and the executive. Businesses want to keep their best people and incentivize outstanding performance. Executives appreciate having financial incentives and understanding what the financial arrangements will be if the company is sold or their employment ends.

We wrote this article for businesses and nonprofits that have key executives. We also wrote it for individuals who have considered or who might consider entering into an employment agreement. We examine two aspects of employment agreements that are easily overlooked and can cause big problems: deferred compensation and payments upon the sale of a business. The good news is that you can avoid potential problems with proper advance planning.

Deferred Compensation

Deferred compensation is compensation earned in one year but paid in a future year. A formal deferred compensation plan promises the executive cash payments in future years based upon the occurrence of certain events. A less obvious example would be a paragraph in an employment agreement that promises a certain payment upon retirement. A severance benefit paid in installments that last more than two years can also be a type of deferred compensation. Many bonus programs and long-term incentive plans, severance plans, and equity-based compensation arrangements also involve deferred compensation, even though they are not commonly thought of as deferred compensation plans.

Why the IRS Cares About Deferred Compensation

Companies and individuals want deferred compensation to be taxable income to the individual only when he or she actually receives the payment. For many years, there were abuses where taxpayers deferred the taxes while retaining the ability to control the timing of the payouts. In the view of the IRS, this meant that the compensation was not really deferred because the executives had the ability to receive it when they wanted to, a situation known as “constructive receipt.” Then came the Enron scandal in which executives accelerated their deferred compensation payouts to receive them prior to paying company employees and creditors.

Internal Revenue Code Section 409A Changes the Landscape

Internal Revenue Code Section 409A was enacted in 2005 to eliminate abuses by providing objective rules regarding the timing of elections, distributions, and payouts. Section 409A requires that the schedule for payout of deferred compensation be defined well in advance and imposes other restrictions on the payment of deferred compensation. If a deferred compensation arrangement does not comply with Section 409A requirements, the taxpayer receiving the deferred compensation is subject to significant penalties.

The Section 409A rules affect many types of deferred compensation, including certain severance and long-term bonus plans. However, Section 409A does not cover tax-qualified retirement plans such as 401(k) and pension plans, welfare benefit plans, incentive stock option plans, restricted stock plans, and certain types of severance plans.

Penalties for Failure to Comply with Section 409A

Section 409A has teeth. If a covered deferred compensation arrangement violates any Section 409A rules, the taxpayer receiving the deferred compensation is required to include all deferred compensation in income in the current tax year, to the extent not subject to a substantial risk of forfeiture and not previously included in income, even if the executive has not yet received the payment. The employee must also pay an additional tax of 20 percent in addition to his or her regular income tax obligations, as well as a premium interest tax.

How to Comply with the Deferred Compensation Rules

The Section 409A rules are complex. Given the significance of the potential penalties, your attorney should review any deferred compensation arrangement or executive employment agreement to make sure that it complies. Here are the key features that will help keep you compliant:

Initial Deferral Elections. An employee's election to defer compensation must generally be made prior to the beginning of the year in which the compensation is earned. However, an employee may elect to defer performance-based compensation after the start of the year in which it is earned, as long as the election is made no later than six months before the end of the year.

Distribution Events. Section 409A specifies the distribution events that may trigger payment of deferred compensation. A deferred compensation arrangement may use one or more of these events, either as individual triggers or in combination. The permissible distribution events are separation from service, death, disability, unforeseeable emergency, change in control, or a fixed time or schedule.

Prohibition on Acceleration of Distributions. A covered deferred compensation arrangement generally may not permit acceleration of the time or schedule of distributions.

Subsequent Deferral Elections. An employee may elect to delay or change the time or form of a distribution of deferred compensation after the initial election to defer compensation, but with substantial restrictions. The subsequent deferral election must be made at least one year before it will take effect, and it must defer the distribution until at least five years after it otherwise would have been made (except in cases of death, disability, or unforeseeable emergency).

Specified Employees. If the employee receiving the deferred compensation is a "specified employee," a category that includes certain owners and highly paid officers, any separation pay may have to be delayed for six months from the date of termination.

Several types of compensation arrangements are not considered "deferred compensation" under Section 409A, even though they could be paid in a future year or even after termination of employment. They are:

> *Short-term Deferral.* Amounts paid within two and one-half months after the end of the tax year in which they are earned are not considered deferred compensation under Section 409A, even though they are paid in a future tax year. The short-term deferral rule ensures that properly structured annual bonuses and incentive payments will not be subject to Section 409A.
>
> *Separation Pay.* Separation pay that is payable to an employee due to involuntary termination of employment (that is, a termination by the employer without cause or resignation by the executive for good reason) may not be subject to Section 409A. If this separation payment does not exceed the lesser of (1) a dollar limit set by the tax laws, which is $265,000 for 2016, or (2) two times the annual compensation for the employee at the time of separation, then the separation pay is not subject to Section 409A if the entire payment is paid no later than the end of the second tax year following the year in which the termination occurs.
>
> *Grandfathered Plans.* Compensation arrangements in effect prior to October 4, 2004, that are not materially modified after that date are not subject to Section 409A, to the extent that deferred compensation is earned and vested as of December 31, 2004.

Section 409A can add complexity to executive compensation agreements and may restrict your choices about when payment will be made. A noncompliant arrangement can be difficult and costly to fix. However, you can avoid these problems by careful advance planning with your attorney.

Golden Parachutes

A "golden parachute" is a payment to an executive that results from a sale of the company or some other change of control. A "parachute" provides the executive with a soft landing after losing her or his title or employment. Companies use golden parachutes to attract and retain key executives. Golden parachutes also help neutralize an executive's tendency not to pursue sale opportunities that may benefit other shareholders for fear of losing his or her job and income.

Golden parachutes are usually promised only to senior executives. A typical golden parachute might provide an executive with a payment equal to one, two, or even three times his or her annual compensation. Often the size of the parachute is structured to correlate to the executive's rank and influence on the company's decision-making processes. Some parachutes include a "double trigger," meaning that they only pay out if there is both a change of control and the executive's employment is terminated after that change.

The Golden Parachute Tax

In the 1980s, Congress enacted Internal Revenue Code Section 280G and related sections to curb perceived abuses. At the dawn of the leveraged buyout era, some executives received huge parachutes worth millions and even tens of millions of dollars. The Section 280G golden parachute taxes were enacted in 1984 to impose limits on amounts that executives could receive following company takeovers.

The golden parachute rules apply to employees or independent contractors who are officers, shareholders, or highly compensated individuals with respect to a company subject to Section 280G. These employees or independent contractors are known as "disqualified individuals." A disqualified individual will be subject to the golden parachute rules when the present value of certain change in control payments and benefits equals or exceeds a certain threshold—three times his or her "base amount." The base amount is the disqualified individual's average taxable compensation for the five years preceding the year of the change in control. If the change in control compensation exceeds the threshold by even $1.00, then the golden parachute rules will apply, and all of the change in control benefits and payments received by such person will be considered "excess parachute payments" to the extent they exceed one times his or her base amount.

If triggered, the cost of the golden parachute tax provisions can be enormous. Section 280G disallows a company's deduction of excess parachute payments paid to disqualified individuals. But the company is not the only party that suffers when an amount is classified as an excess parachute payment: the rule also imposes a steep, nondeductible 20 percent excise tax on any disqualified individual who receives an excess parachute payment.

Implications for Privately Held Companies

The rules apply only to certain individuals at certain companies. Publicly traded companies are subject to the golden parachute rules, and most plan their executive compensation accordingly. However, the golden parachute rules are not limited to public companies. Privately held companies and family businesses are also subject to the golden parachute rules unless they fit within either the S corporation exemption or the prior approval exemption. Companies that are subchapter S corporations (or that are eligible to elect S corporation status immediately before the change in control) are not subject to the golden parachute rules. A private company can also avoid the taxes by following a prior approval process described below.

Strategies for Avoiding Golden Parachute Tax Problems

There are strategies to avoid triggering the golden parachute taxes in cases where benefits are contingent on a change in control. Here are some common strategies for avoiding Section 280G:

Limiting Change in Control Compensation. It is now standard practice for many companies to design packages that specifically pay an amount equal to 2.99 times base salary or include "Section 280G clawback" provisions, which can cap change in control compensation at 2.99 times base salary and recoup the excess if the payment of the amount at any other metric would push the individual over the Section 280G threshold.

Covenants Not to Compete. An amount that is allocated to a covenant not to compete following a change in control is generally not considered to be a Section 280G payment, as it relates to services to be performed after the change in control.

Private Companies and Prior Approval. Private companies are allowed to treat certain payments as exempt from Section 280G if they follow specific disclosure and shareholder approval procedures. The approval process and related disclosures can be complicated, so careful planning is needed if you want to rely on this exemption.

Increase in Base Compensation. If an employee who anticipates a change in control is able to increase his or her base compensation amount, that employee will increase his Section 280G threshold. This could be accomplished by exercising options, which may result in ordinary income reported on an IRS Form W-2, and by stopping any deferrals of income.

As with Section 409A, the golden parachute rules add additional complexity to certain companies' executive compensation agreements. However, if companies and executives are aware of these rules and can anticipate these issues when they start negotiating and drafting agreements, compliance can help the parties avoid headaches upon the occurrence of a future change in control.

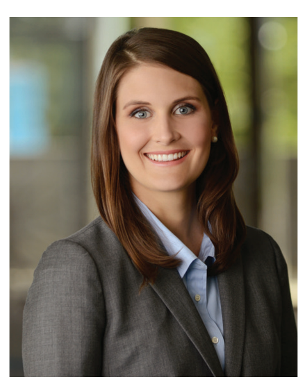
This article was authored by our legal colleagues at Varnum LLP in Grand Rapids, Michigan, a fellow member of Ally Law, an international alliance of law firms that allows us to provide our clients with legal support across the globe. Ally Law includes over 1,300 lawyers in more than 40 countries, including offices in the world's money centers, major business markets, and emerging commercial hubs. Our alliance provides access to global markets through local attorneys who understand their communities' business climates and cultures.

John is a partner with Varnum LLP.

He practices employee benefits, corporate, and tax law, advising businesses with respect to ERISA and IRS requirements for qualified and nonqualified plans. John also counsels clients on employee benefits issues in the context of corporate transactions and on executive employment agreements and incentive plans. John earned his BA from Williams College and his JD from Northwestern University School of Law and is a member of the Michigan and Illinois Bars.

Katie is an associate with Varnum LLP.

She is a member of the firm's tax and employee benefits practice teams and focuses on federal income tax matters for both foreign and domestic clients and issues pertaining to employee benefits and executive compensation. Katie earned her LLM in taxation from Northwestern University School of Law and her JD from Loyola University Chicago School of Law. She is a council member of the State Bar of Michigan's Taxation Section and recently finished tenures as the young lawyers section liaison and editor of the *Michigan Tax Lawyer*, the section's quarterly taxation publication.



Retirement Plan Beneficiary Designations: Go Ahead and Take a Second Look

~ Rose-Anne B. Frano

It is satisfying to check items off our to-do lists, especially for busy executives working hard to grow their businesses and achieve financial success. As easy as it may appear to fill in a few blanks and return a beneficiary designation for your IRA, pension plan, 401(k), or other retirement account and then mark it "complete" on your to-do list, this approach comes with risks. Your beneficiary designation is an important estate planning document that should be reviewed regularly, considered carefully (often with advice from your attorney), and prepared as thoughtfully as you prepare your last will and testament or revocable trust. Go ahead—take a second look at your retirement plan beneficiary designation to ensure you have thoughtfully considered and carefully drafted it, and encourage your valuable employees to do the same.

A Considered Plan

Step One: Ask the custodian of your retirement plan to provide you with a copy of your filed beneficiary designation and confirm you have a current and effective beneficiary designation filed with the plan custodian. Carefully read the filed beneficiary designation form and review how your stated beneficiaries would receive the plan benefits if your death were to occur at that moment. Take the time to read not only the beneficiary name you have included, but also the "small print." What happens if a beneficiary predeceases you? What happens if a beneficiary is a minor? What happens if you have a later-born child? What happens if you are divorced from a named beneficiary? What happens if you have married since you filed the beneficiary designation? Can your spouse roll over the retirement plan to his or her sole name after your death? Are there any required beneficiaries of the plan by reason of law or plan terms (such as a spouse or an ex-spouse)?

Step Two: Decide if any revisions are required or desired to your filed designated beneficiary form. Review the desired or required changes with your estate planning attorney and financial advisor to ensure that you understand the effect of considered changes and that such changes will dovetail with your overall estate planning objectives. When you complete your revisions, submit your updated beneficiary designation form as required by your retirement plan and ask for written confirmation of receipt by the plan custodian.

Step Three: Provide a copy of filed beneficiary designations to your estate planning attorney for his or her files whenever you modify your beneficiary designations. It is critical that you treat your retirement plan beneficiary designations as one of your core estate planning documents because only the beneficiary designation you execute and file with the plan custodian (or in the absence of a filed effective beneficiary designation, as the applicable law and the plan's underlying terms direct) will govern the disposition of such retirement account after your death. However, the estate tax effects of the disposition of the retirement account are governed by the tax apportionment provisions of your estate plan, and, most assuredly, you want to ensure the retirement plan beneficiary designation works as part of your overall estate plan.

Step Four: Repeat steps one through three at every major life event, or at least annually. Make this review part of an annual financial well-check. Important life events prompting you to consider a sooner review of your filed beneficiary designation may include a change in your job, the birth of a child or grandchild, a change in marital status (married, divorced, separated, or widowed), a change in your health, or a change in your philanthropic goals (both during your lifetime and at death).

Important Reminders

Retirement plans have unique tax attributes, and how you designate your beneficiaries can have significant tax consequences to the beneficiary and your estate. Be responsible with these decisions and knowledgeably review, revise, and update your beneficiary designations in consultation with your legal, accounting, and financial advisors.

Do not underestimate the importance of the tax qualities of one retirement plan type as compared to another and as compared to other assets of your estate. For example, Roth IRAs, as compared to traditional IRAs, will have very different ultimate benefits to a designated beneficiary because of the inherent tax implications of the two plan types. Likewise, your profit-sharing plan may have multiple distribution options available to your beneficiary (e.g., lump sum, over a period of years, over a life expectancy), so you need to consider whether or not you want your beneficiary making one distribution choice or another. Can you restrict the options available to a beneficiary for distribution? Should you educate your beneficiary about the choices and the consequences of each choice? Furthermore, one size does not fit all. If you have multiple plans, you should both consider each plan's designated beneficiary separately and also as a coordinated part of your overall estate plan.

Knowledgeably decide how to designate a beneficiary of your retirement plan. The tax and distribution laws that govern retirement plans are technical and stark. The designation of a beneficiary without proper education as to the tax or distribution results can be calamitous. It is critical that you consult with proper advisors as to your beneficiary designations to ensure that the laws and distribution rules of your plan will apply as you intend. With that said, for the most part, you can work within the rules to carry out your intentions. Trusts, charities, and family members can all be very good beneficiaries of your retirement plan, but the beneficiary designation itself and the supporting documents required (e.g., a trust that will be the beneficiary of the retirement plan) also must be technically considered and drafted to ensure that your intentions are not disrupted by the tax laws and plan distribution rules that will apply.

The distribution of retirement plans may be controlled by your beneficiary designation, but the value of the retirement plan is still considered part of your gross estate for federal estate tax purposes. Therefore, you should consider how the estate tax attributable to the retirement plan, if any, will be paid by your estate and/or by the plan beneficiaries.

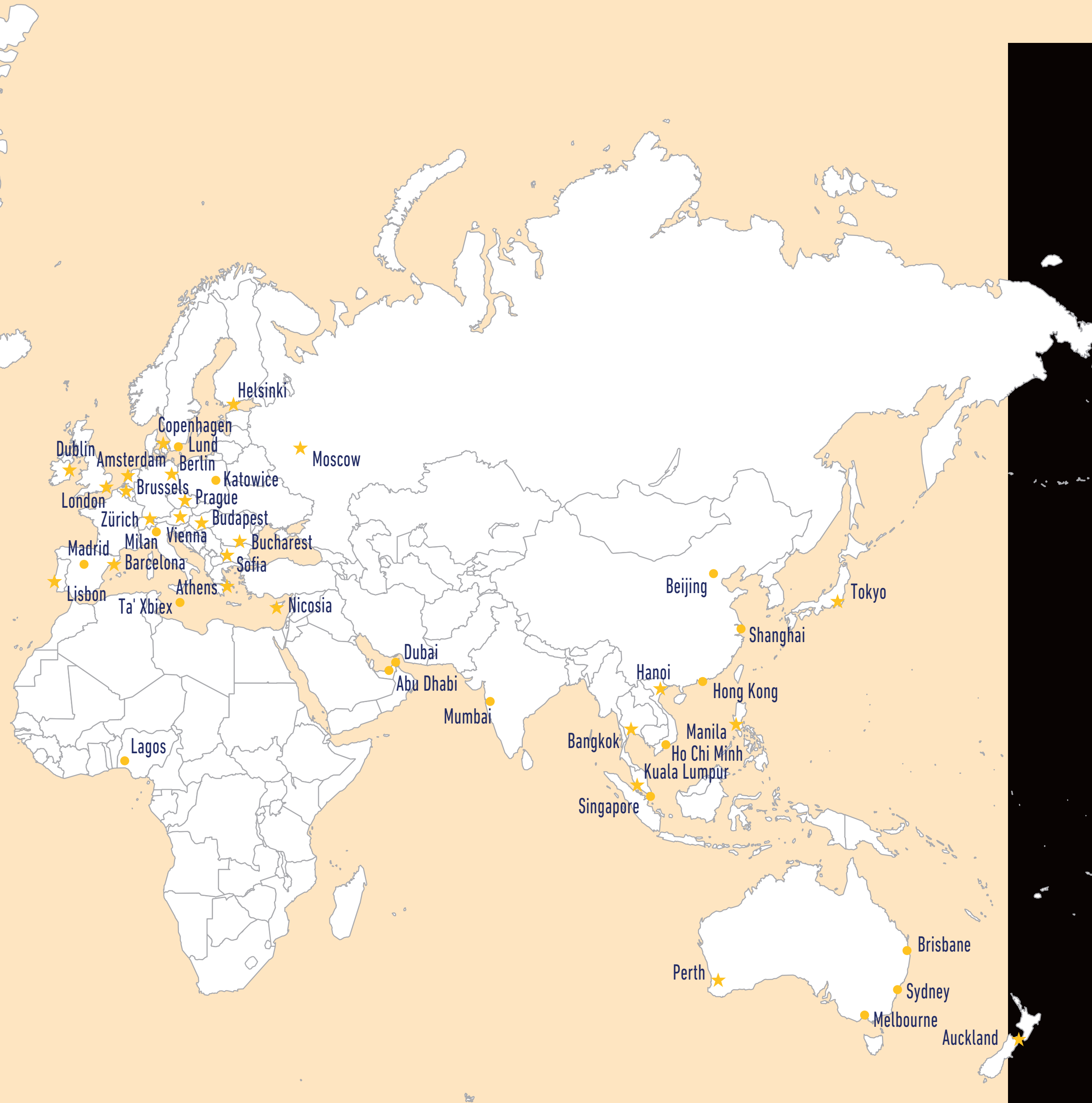
For many individuals, retirement plans are significant assets of their estates. Designating a beneficiary of your retirement plan is as important as, and at times can be more technical than, the preparation of other estate planning documents. Do not minimize the importance of reviewing and updating the beneficiary designation of your retirement plan, and do so with the counsel of your legal, financial, and tax advisors who can help you navigate the many complicated rules that will impact the outcome of your beneficiary choices. If possible, encourage your company to establish good systems to remind employees of the importance of these retirement accounts, both as to participation and as to regular review of the participants' designated beneficiaries of their retirement plans. Make this a part of your annual financial well-check, and also encourage your valued employees to do the same.

Rose-Anne is a Williams Parker shareholder.
She is a board certified specialist in wills, trusts, and estates. Rose-Anne focuses on estate, gift, and generation-skipping transfer tax planning for individuals and their families and on the administration of estates and trusts. She earned her LLM in Taxation and her JD from the University of Florida College of Law and her BA from Tulane University.

GLOBAL REACH

INTERNATIONAL LAW FIRM ALLIANCE

Williams Parker has international reach as a member of Ally Law—one of the world's leading law firm networks. From the complexities of expansion into foreign markets, interpreting international tax treaties, international litigation and arbitration, mergers and acquisitions involving non-US entities, and joint manufacturing or distribution arrangements with non-US entities, to labor and employment matters outside of the United States, we work regularly with Ally Law attorneys to make sure our clients receive the legal support they need wherever they need it. Ally Law includes over 1,300 lawyers in more than 40 countries, including offices in the world's money centers, major business



markets, and emerging commercial hubs. Each firm in the network goes through a rigorous vetting process and abides by the International Bar Association's International Code of Ethics. Our alliance provides access to global markets through local attorneys who understand their communities' business climates and cultures.

AllyLaw

ATTORNEYS BY PRACTICE

BANKING & FINANCE
Peter T. Currin
Michele B. Grimes
M. Lewis Hall III
James-Allen McPheeters
James L. Ritchey
Michael J. Wilson

CORPORATE
Nicole A. Behar
Robert W. Benjamin
Zachary B. Buffington
R. David Bustard
Juliana Ferro
Thomas J. McLaughlin
James-Allen McPheeters
John L. Moore
Elizabeth M. Stamoulis
James L. Turner
E. John Wagner II
Michael J. Wilson

ESTATE PLANNING, BUSINESS SUCCESSION, ESTATE & TRUST ADMINISTRATION
John T. Berteau
Elizabeth P. Diaz
Douglas J. Elmore
Rose-Anne B. Frano
Ric Gregoria
William T. Harrison Jr.
Susan Barrett Hecker
Elizabeth C. Marshall
Thomas J. McLaughlin
Patrick W. Ryskamp
Jeffrey T. Troiano
Daniel L. Tullidge
James L. Turner
E. John Wagner II

ESTATE & TRUST LITIGATION
M. Lewis Hall III
Bonnie Lee Polk
Mark A. Schwartz

HEALTHCARE
Zachary B. Buffington
William T. Harrison Jr.
John L. Moore

INTERNATIONAL CLIENT SERVICES

Robert W. Benjamin
Juliana Ferro
Michele B. Grimes
Susan Barrett Hecker
Daniel L. Tullidge
Michael J. Wilson

LABOR & EMPLOYMENT

Lindsey L. Dunn
Gail E. Farb
Jennifer Fowler-Hermes
John M. Hament
Kimberly Page Walker

LAND USE, DEVELOPMENT & LOCAL GOVERNMENT

Charles D. (Charlie) Bailey III
Charles D. (Dan) Bailey Jr.
Erin H. Christy
William T. Harrison Jr.

LITIGATION

Lindsey L. Dunn
Gail E. Farb
Jennifer Fowler-Hermes
Tommy E. Gregory
M. Lewis Hall III
John M. Hament
Bonnie Lee Polk
Mark A. Schwartz
Kimberly Page Walker

REAL ESTATE

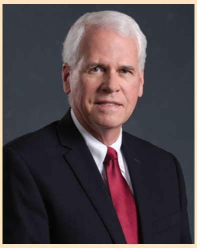
Erin H. Christy
Terri Salt Costa
Peter T. Currin
Juliana Ferro
Christa L. Folkers
Jeffrey A. Grebe
Michele B. Grimes
William T. Harrison Jr.
J. Michael Hartenstine
Ryan P. Portugal
James L. Ritchey
Patrick W. Ryskamp
William M. Seider
James L. Turner

TAX, TAX CONTROVERSIES & TAX EXEMPT ORGANIZATIONS

Nicole A. Behar
Robert W. Benjamin
Ric Gregoria
William T. Harrison Jr.
Susan Barrett Hecker
Thomas J. McLaughlin
James L. Turner
E. John Wagner II
Michael J. Wilson

ATTORNEY DIRECTORY

Charles (Charlie) D. Bailey III
Shareholder
T: (941) 552-5551
E: cbailey@williamsparker.com



Charles (Dan) D. Bailey Jr.
Shareholder
T: (941) 329-6609
E: dbailey@williamsparker.com

Nicole A. Behar
Counsel
T: (941) 329-6632
E: nbehar@williamsparker.com

Robert W. Benjamin
Counsel
T: (941) 329-6615
E: rbenjamin@williamsparker.com

John T. Berteau
Counsel
T: (941) 329-6607
E: jberteau@williamsparker.com

Zachary B. Buffington
Associate
T: (941) 893-4000
E: zbuffington@williamsparker.com

R. David Bustard
Shareholder
T: (941) 329-6629
E: dbustard@williamsparker.com

Erin H. Christy
Associate
T: (941) 893-4007
E: echristy@williamsparker.com

Terri Salt Costa
Shareholder
T: (941) 329-6617
E: tcosta@williamsparker.com

Peter T. Currin
Shareholder
T: (941) 536-2030
E: pcurrin@williamsparker.com

Elizabeth P. Diaz
Associate
T: (941) 329-6631
E: ediaz@williamsparker.com

Lindsey L. Dunn
Associate
T: (941) 552-2556
E: ldunn@williamsparker.com

Douglas J. Elmore
Associate
T: (941) 329-6637
E: delmore@williamsparker.com

Gail E. Farb
Counsel
T: (941) 552-2557
E: gfarb@williamsparker.com

Juliana Ferro
Associate
T: (941) 329-6616
E: jferro@williamsparker.com

Christa L. Folkers
Counsel
T: (941) 552-5554
E: cfolkers@williamsparker.com

Jennifer Fowler-Hermes
Counsel
T: (941) 552-2558
E: jfowler-hermes@williamsparker.com

Rose-Anne B. Frano
Shareholder
T: (941) 536-2033
E: rfrano@williamsparker.com

Jeffrey A. Grebe
Shareholder
T: (941) 329-6619
E: jgrebe@williamsparker.com

Ric Gregoria
Shareholder
T: (941) 536-2031
E: rgregoria@williamsparker.com

Tommy E. Gregory
Associate
T: (941) 536-2036
E: tgregory@williamsparker.com

Michele B. Grimes
Shareholder
T: (941) 329-6611
E: mgrimes@williamsparker.com

M. Lewis Hall III
Shareholder
T: (941) 536-2032
E: lhall@williamsparker.com

John M. Hament
Counsel
T: (941) 552-2555
E: jhament@williamsparker.com

William T. Harrison Jr.
Shareholder
T: (941) 329-6601
E: wharrison@williamsparker.com

J. Michael Hartenstine
Shareholder
T: (941) 329-6610
E: mhartenstine@williamsparker.com

Susan Barrett Hecker
Counsel
T: (941) 329-6625
E: shecker@williamsparker.com

Elizabeth C. Marshall
Shareholder
T: (941) 329-6614
E: emarshall@williamsparker.com

Thomas J. McLaughlin
Shareholder
T: (941) 536-2042
E: tmclaughlin@williamsparker.com

James-Allen McPheeters
Associate
T: (941) 329-6623
E: jamcpheeters@williamsparker.com

John L. Moore
Shareholder
T: (941) 329-6620
E: jmoore@williamsparker.com

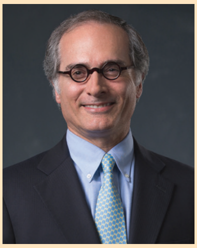
Bonnie Lee Polk
Counsel
T: (941) 552-5548
E: bpolk@williamsparker.com

Ryan P. Portugal
Associate
T: (941) 329-6626
E: rportugal@williamsparker.com

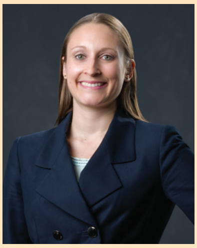
James L. Ritchey
Shareholder
T: (941) 329-6604
E: jritchey@williamsparker.com

Patrick W. Ryskamp
Shareholder
T: (941) 536-2035
E: pryskamp@williamsparker.com

Mark A. Schwartz
Shareholder
T: (941) 329-6621
E: mschwartz@williamsparker.com



William M. Seider
Shareholder
T: (941) 329-6613
E: wseider@williamsparker.com



Elizabeth M. Stamoulis
Associate
T: (941) 552-5546
E: estamoulis@williamsparker.com

Jeffrey T. Troiano
Shareholder
T: (941) 329-6638
E: jtroiano@williamsparker.com

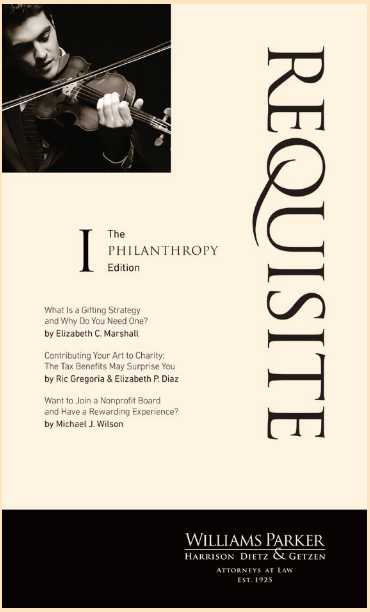
Daniel L.Tullidge
Associate
T: (941) 329-6627
E: dtullidge@williamsparker.com

James L. Turner
Shareholder
T: (941) 329-6612
E: jturner@williamsparker.com

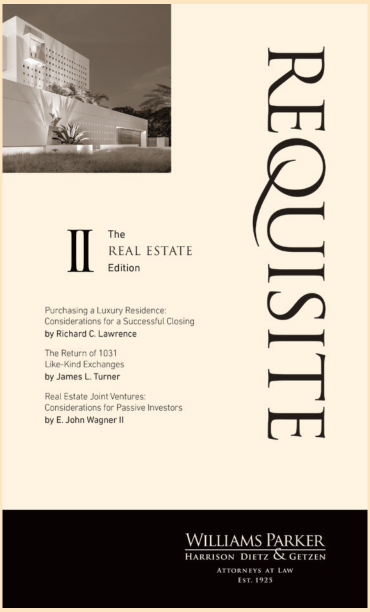
E. John Wagner II
Shareholder
T: (941) 536-2037
E: jwagner@williamsparker.com

Kimberly Page Walker
Counsel
T: (941) 329-6628
E: kwalker@williamsparker.com

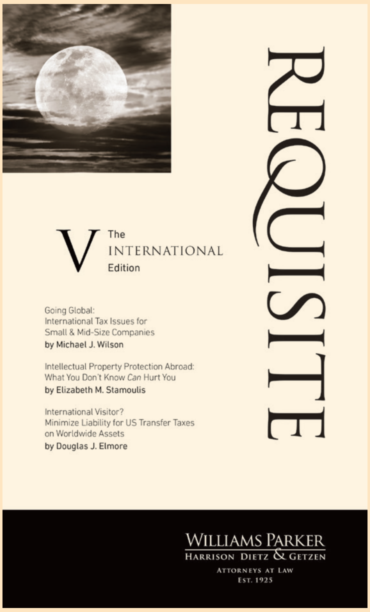
Michael J. Wilson
Shareholder
T: (941) 536-2043
E: mwilson@williamsparker.com



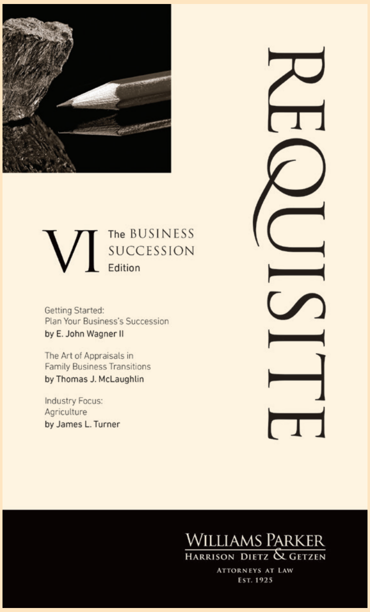
The Philanthropy Edition



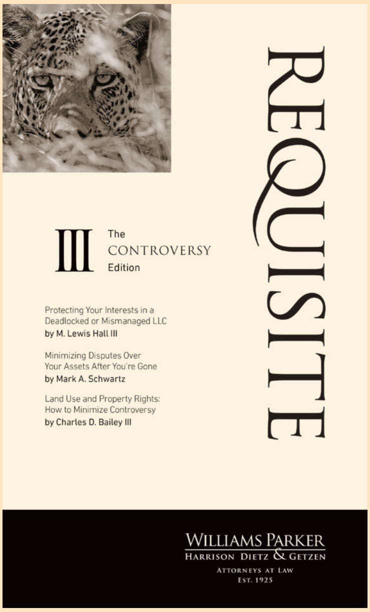
The Real Estate Edition



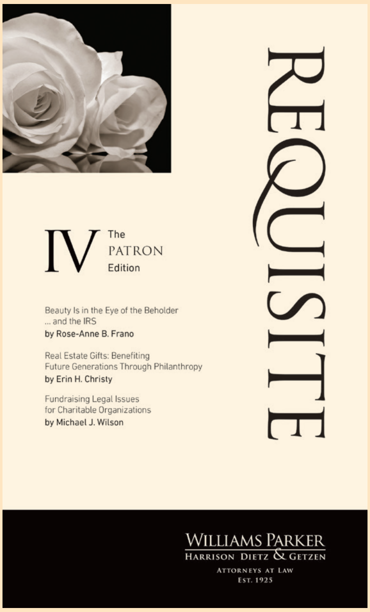
The International Edition



The Business Succession Edition



The Controversy Edition



The Patron Edition

The Private Foundation Edition

The Library Is Open.

To view previous editions of *Requisite*, please visit williamsparker.com/requisite.

COMMUNITY

Sarasota has a rich tradition of strong civic organizations and community engagement, especially regarding community foundations and arts, cultural, and human services organizations. We are proud of the central roles played by our attorneys and staff, forging some of the area's most enduring and iconic institutions and leading organizations and initiatives that contribute to the area's good fortune and character. We are delighted to call Sarasota home.

OVERVIEW

Williams Parker was founded in 1925. We are native Floridians as well as "transplants." Every one of us lives and works here because the quality of life in our region is second to none.

We are hard-working, fair-minded, and community-centered attorneys who support and collaborate with one another. Our large base of loyal clients is our most important source of new clients. Our clients are primarily developers, entrepreneurs, governmental entities, and families of means. They appreciate our attentiveness, discretion, and judgment.

We recruit carefully, which means we enjoy low turnover among our employees. A large percentage of our attorneys have advanced degrees in law (LLM), accounting (master's or CPA), or business (MBA). Our technical legal skills match our clients' demands for solutions to a wide range of complex legal challenges here and abroad.

To meet our clients' needs over time, we have expanded our ranks. We practice from a single office to create operating efficiencies for our clients and to permit us to maintain our hallmark collegiality.

Our clients' legal challenges often involve matters in other states or countries. We regularly work with attorneys in an international network of similarly situated law firms to help our clients secure the legal support they need wherever they need it. This network of corporate and tax attorneys operates globally and provides our clients with a practical way to access global markets and foreign counsel.

WILLIAMS PARKER
HARRISON DIETZ & GETZEN

ATTORNEYS AT LAW
EST. 1925


200

Printed in the United States of America

200 South Orange Avenue | Sarasota, Florida | 34236
PHONE (941) 366-4800 | FAX (941) 366-5109

WilliamsParker.com

Williams Parker
Harrison Dietz & Getzen
Attorneys at Law
Est. 1925