



How To Motivate Your Employees... While Protecting Your Company

October 20, 2009

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Brian J. Burt

Partner, Snell & Wilmer, L.L.P



Brian advises entrepreneurs and emerging growth companies in all stages of development, from formation to liquidity.

Having previously founded, capitalized, and run his own company, he brings a “real world” perspective to his practice. Brian graduated from Harvard Law School and is the Chair of Snell & Wilmer’s Emerging Business Group.



How To Motivate Your Employees...While Protecting Your Company

It’s not easy being an employee these days. The current downturn has brought layoffs, salary cuts, and benefit reductions to virtually every industry. Even those who have not been personally affected are faced with an uncertain economic future, and the fear and stress that such uncertainty breeds

Business owners recognize that low employee morale can translate into deteriorating productivity and, ultimately, reduced revenue.

Snell & Wilmer L.L.P. partner Brian J. Burt will discuss ways to motivate your employees.

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A little background

- ❑ Founded in 1938
- ❑ Largest law firm in Phoenix and Arizona, and one of largest in the West with more than 400 lawyers in 8 offices
- ❑ Offices in Phoenix, Tucson, Los Angeles, Orange County, Denver, Las Vegas, Salt Lake City, and Los Cabos
- ❑ A true full-service firm – all of the legal services required to help you start, grow and sell your business
 - Business, labor and employment, commercial finance, private equity, real estate, immigration, litigation, intellectual property, franchise, employee benefits, healthcare, tax, estate planning, environmental, mergers and acquisitions
- ❑ Ranked the best corporate law firm in Phoenix for the 8th consecutive year by Corporate Board Member magazine
- ❑ Learn more - www.swlaw.com



Today's Presenter

Brian J. Burt

Partner and Chair of the Emerging Business Group

Brian advises entrepreneurs and emerging growth companies in all stages of development, from formation to liquidity. He also represents banks, financial services companies, private investors, and venture capital funds. Brian has extensive experience in corporate organization and governance; private equity and debt financing; shareholder/owner relations and disputes; employee incentive programs; supplier/manufacturing agreements; securities regulation; technology transfer and licensing; joint ventures and strategic alliances; and mergers and acquisitions.

He represents clients in a wide variety of industries, including banking and financial services, biotechnology, capital investment, consumer products and services, education, entertainment/media, high tech, Internet, manufacturing, marketing/public relations, nutraceuticals, professional services, real estate development, and software and information technology.

Having previously founded, capitalized and run his own company, Brian brings a unique "real world" perspective to his practice.

Education

- Harvard Law School (J.D., 1998) - Managing Editor, *Harvard Journal of Law & Public Policy*
- Allegheny College (B.A., Political Science & Philosophy, *summa cum laude*, 1995) - Valedictorian, Phi Beta Kappa

Community Involvement

- Better Business Bureau of Central, Northern & Western Arizona, Board of Directors
- Boy Scouts of America
- Invest Southwest Capital Conferences, Mentor Team Captain
- Junior Achievement, High School Economics and Business Ethics Instructor
- Valley Leadership, Class XXX



Agenda

- 1) Improving life at the office
- 2) Improving quality of life
- 3) Creating job security with employment agreements
- 4) Use of performance and liquidity bonuses
- 5) Giving employees “ownership” without giving up equity
- 6) Making employees owners – stock options, stock grants, and LLC profits interests

Improving Life At The Office

- ❑ Build (or rebuild) trust
 - ❑ Create a vision...and then hire individuals who believe in it
 - ❑ Operate with integrity (i.e., do what you say you will do)
 - ❑ Ensure leaders are competent, authentic and decisive
 - ❑ Foster open communication (even when the news is bad)
 - ❑ Balance consistency with innovation
- ❑ Lead by example (and not by fear)
- ❑ Create a respectful workplace
- ❑ Provide regular feedback and individual recognition
- ❑ Establish a clear path for career advancement

Improving Life At The Office

- ❑ Comfortable working environment
- ❑ Quality administrative support
- ❑ Reliable technology
- ❑ Milestone or performance rewards programs
- ❑ Company events (holiday parties, company picnic, etc.)
- ❑ Team building activities
- ❑ Flex-time
- ❑ Telecommuting (or “work from home” days)
- ❑ Ask employees what they need to succeed...and actually listen

Improving Quality of Life

“Now more than ever,
employees value their benefits”

- ❑ 41% of employees consider workplace benefits to be the foundation of their personal safety net
- ❑ 40% of employees says that benefits play an important role in their decision to stay with their employer

Benefit Satisfaction

High

Low

Job Satisfaction

73%

22%

Source: MetLife 7th Annual Study Of Employee Benefit Trends

Improving Quality of Life

“There is a significant gap between employer and employee perceptions of how benefits contribute to loyalty”

<u>Benefit</u>	<u>Valued by Employee</u>	<u>Employer Perception</u>
Health	75%	59%
Retirement	72%	40%
All other insurance	69%	41%
Retirement advice	51%	19%
Financial advice	38%	10%

Source: MetLife 7th Annual Study Of Employee Benefit Trends

Improving Quality of Life

“This gap in perception highlights missed opportunities to deliver and get the most from each benefits dollar.”

Benefits to consider

- ❑ Financial planning services (including retirement seminars)
- ❑ Benefit advisors
- ❑ Work-life solutions (flex time and telecommuting)
- ❑ Preventative health and wellness programs (weight loss, stress reduction, smoking cessation, etc.)

Source: MetLife 7th Annual Study Of Employee Benefit Trends

Creating Job Security With Employment Agreements

Two Types of Employment

At-Will

Employers can terminate an employee with or without cause

Exceptions:
discrimination, retaliation,
exercising legal rights,
refusing to do illegal acts

Employment Agreement

Employers have restrictions on their ability to terminate an employee

Creating Job Security With Employment Agreements

At-Will or Employment Agreement?

- ❑ Owner says to employee: “Don’t worry, we’ll take care of you.”
- ❑ Employee handbook specifies a process for terminating employees.
- ❑ Supervisor says to employee during a review: “You’ll have a job as long as you continue to perform.”
- ❑ Employee handbook provides that an employee will only be terminated for “just cause.”

Creating Job Security With Employment Agreements

To avoid issues related to at-will employment...

- ❑ Document at-will status in all written materials, including employment application, offer letter and employee handbook...and do so consistently
- ❑ Provide that at-will status cannot be changed by any oral statements
- ❑ Provide that at-will status cannot be changed by any written statements apart from those issued by a certain officer/manager
- ❑ Follow any termination procedures set forth in written materials

Creating Job Security With Employment Agreements

What are the terms of the employment agreement if....

- it provides that termination can only occur for “cause” but does not define that term?
- it defines “cause” but does not include a employment term?
- it provides the employee’s title/position, but does not specify the related responsibilities or how they can be changed?
- it provides that the employee may receive a performance bonus but does not indicate how it will be determined or by whom?
- it does not specify what compensation and benefits will be received in the event employee is terminated without “cause”?

Creating Job Security With Employment Agreements

Minimum Employment Agreement Terms

- ❑ Position and responsibilities/duties (and ability to change/expand)
- ❑ Salary (and how it can be changed)
- ❑ Benefits (reserving right to change)
- ❑ Initial term (start and end date) and renewal term(s) (if any)
- ❑ Termination - define “cause”, permit termination without cause
- ❑ Severance - for termination without “cause” (can be shorter than term), include release requirement
- ❑ Bonus (if any) – eligibility, calculation

Use of Performance and Liquidity Bonuses

Types of Bonus Programs

<p>Completely <u>Discretionary</u> (no formal plan)</p>	<p>Minimum Eligibility / <u>Discretionary Amount</u></p>	<p>Minimum Eligibility / <u>Fixed Amount or Formula</u></p>
<ul style="list-style-type: none">❑ No eligibility standards❑ No fixed amount or formula❑ <u>Examples</u>: quarterly or year-end bonus, cost-savings bonus, worker appreciation	<ul style="list-style-type: none">❑ Minimum eligibility criteria (individual and/or company performance)❑ Discretionary amount❑ <u>Example</u>: minimum sales for bonus eligibility	<ul style="list-style-type: none">❑ Minimum eligibility criteria❑ Amount is fixed or determined by formula❑ <u>Example</u>: achievement of sales targets yields specified bonus

The Liquidity Bonus

When an employee wants a “piece of the company”
a liquidity bonus will often satisfy expectations

The Liquidity Bonus

- ❑ A liquidity bonus can be a fixed amount or based on a formula
 - ❑ If using a formula, base the amount on actual profits from the liquidity event
 - ❑ Can also incorporate performance requirements
 - ❑ Establish clear eligibility criteria to ensure employee is present at time of sale and motivated to help close the deal
 - ❑ Be careful when terminating employees shortly before a sale
 - ❑ Avoids actual ownership and the related issues
- ** Document your plan – oral promises can kill sale transactions

The Liquidity Bonus

Examples

- ❑ Employee will receive a \$250,000 cash payment if he is employed by the company on the day on which the company's sale transaction is closed
- ❑ Employee will receive 2.0% of the Net Proceeds actually received by the company in its sale transaction if she is employed by the company on the day on which the company's sale transaction is closed

“Net Proceeds” means proceeds minus transaction costs, satisfaction of obligations, debt repayment, reserves, etc.

Giving “Ownership” Without Giving Up Equity

When an employee wants a “**piece of the company**”
give “ownership” without giving up equity by using
phantom stock or **stock appreciation rights**

Giving “Ownership” Without Giving Up Equity

Phantom Stock (restricted stock units or RSUs)

A contractual right to receive a cash bonus, at a specified date, in an amount equal to the then fair market value of a certain number of shares of stock

Example: On payment trigger date each share of stock has a FMV of \$1.00 and the employee holds 5 RSUs. Bonus = \$5.00

Stock Appreciation Rights (SARs)

A contractual right to receive a cash bonus in an amount equal to the appreciation in value of a share of company stock between the grant date and the exercise date (often triggered in employee’s discretion after vesting)

Need to determine eligibility criteria, grant amounts, vesting schedules, etc.

Example: Stock value: grant date = \$1.00, exercise date = \$2.50
Bonus = \$1.50 ($\$2.50 - \1.00)

Phantom Stock / Stock Appreciation Rights

Advantages

- ❑ Make employees feel like owners without giving away actual equity
- ❑ Employees share in, and are motivated to contribute to, the company's growth, and do not have to make a cash investment
- ❑ Cash payment avoids issues related to the lack of marketability of equity in a private company
- ❑ Avoids making the employee a minority shareholder
 - ❑ No ownership dilution
 - ❑ No shareholder rights (including voting, meeting, information)
 - ❑ No need for shareholders or buy/sell agreement
- ❑ Employee taxed on date of distribution (unless 409A triggers earlier tax)

Phantom Stock / Stock Appreciation Rights

Disadvantages

- ❑ May not create the same ownership culture as with actual stock ownership
- ❑ Payments are taxed to employees as ordinary income (not capital gain)
- ❑ Financial dilution to actual shareholders due to liability of the obligation
- ❑ Has an adverse impact on cash flow as payments are made
- ❑ Once a RSU/SAR is paid out, employee does not share in future growth of the company (as would with actual stock ownership)
- ❑ Accounting treatment

Other Issues

- ❑ ERISA, tax, accounting, federal and state securities laws

Actual Company Ownership

Ways to make employees owners

Stock Options

Restricted Stock

Stock Purchase

Actual Company Ownership

Stock Options

- ❑ A right to buy a certain number of shares of stock at a stated price (the “exercise” or “strike” price) determined on the date of grant (fair market value on the date of grant)
- ❑ The right to exercise the option is typically subject to a vesting schedule, which can be based on time and/or performance
- ❑ Options are Incentive Stock Options (ISOs) or non-qualified options

	<u>Grant Date</u>	<u>Exercise Date</u>	<u>Sale Date</u>
ISO	No tax	No tax (but AMT)	Capital gain (if holding period)
NQSO	No tax	Ordinary income	Capital gain (if holding period)

- ❑ Pay exercise price with cash or appreciated stock (cashless exercise)

Actual Company Ownership

Restricted Stock

- ❑ An award of a certain number of shares of stock
- ❑ Employee owns the stock upon receipt of the award, but the stock is subject to forfeiture (or a requirement to sell it back to employer) if the vesting conditions are not satisfied
- ❑ Vesting conditions may be based on time and/or performance
- ❑ Option to file an 83(b) election

	<u>Grant Date</u>	<u>Vesting Date(s)</u>	<u>Sale Date</u>
83(b)	Ordinary income	No tax	Capital gain (if holding period)
No 83(b)	No tax	Ordinary income	Capital gain (if holding period)

Actual Company Ownership

LLC Profits Interest

- ❑ A “profits interest” is an award of units of a limited liability company that is not taxable to the employee
- ❑ Provides a share of the future growth of the company
- ❑ Unlike a grant of stock, however, a profits interest does not entitle the employee to a share of the company’s current value
- ❑ Employee can contribute services for a profits interest, and does not have to make any cash contribution
- ❑ Provides current, actual ownership...without the tax bill

Actual Company Ownership

Other Critical Issues

- ❑ Tax - for both employer and employee (409A issues for options)
- ❑ Accounting
- ❑ It's no longer just the founder's company...
 - ❑ Fiduciary duties - The board of directors has fiduciary duties to the company's minority stockholders
 - ❑ Corporate protocols - must follow statutory and governing document requirements for officer appointments, board elections and meetings, shareholder meetings, stock issuances, etc.
- ❑ Shareholders/Operating Agreement (yes, you need one)
 - ❑ Designate board composition (and override state statute)
 - ❑ Transfer rights, drag-along, call rights, dispute resolution mechanism
 - ❑ S corp preservation provisions

Actual Company Ownership

Securities Laws

- ❑ Federal and state securities laws are triggered when just 1 share of stock is offered or sold to 1 person
- ❑ All securities offerings must be (i) registered or (ii) subject to an exemption from registration
- ❑ Rule 701 provides the exemption for compensatory benefit plans
 - ❑ Does not require the employee to be “accredited”
 - ❑ Limited disclosure: only copy of benefit plan (unless more than \$5MM)
 - ❑ Sales limits: greatest of (i) \$1MM, (ii) 15% of company’s total assets, or (iii) 15% of the class of securities offered

Actual Company Ownership

Securities Laws

- ❑ Rule 701 provides the exemption for compensatory benefit plans
 - ❑ No integration with other offerings
 - ❑ Cannot be used to circumvent compensatory purpose and raise capital
 - ❑ Securities are restricted in the hands of employees
 - ❑ Must identify state equivalent exemption
- ❑ Bonus (as opposed to compensatory) plans that are broad-based, involuntary and non-contributory can fall outside of the regime

Thank you for attending

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