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U P D A T E

News of Developments in the Financial Sector and Related Areas

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Employment Agreements, Change in Control Agreements, Confidentiality and Noncompete Provisions

As consolidation continues in the financial sector, banks and bank holding companies should consider the use of employment agreements and change in control agreements to include provisions relating to confidentiality and noncompete for senior management. In the event a bank or bank holding company has either of these agreements in place, they need to be reviewed from time to time to determine if revisions are needed because of economic or legislative changes, including changes in tax laws.

An employment agreement is generally defined as an agreement between a company and its employee which specifies the rights and obligations of each. The term of an employment agreement will normally run for a fixed period of time or it may run for a fixed term plus rolling renewal periods. One of the advantages of a rolling renewal period in an employment agreement is that the parties do not have to renegotiate the agreement at the end of the fixed term. Besides the term, an employment agreement will normally specify such things as duties, salary, bonus, benefits, disability, death and retirement. A change in control agreement is designed to become effective upon a change in control of the company. A few examples of events constituting a change in control are as follows:

- A third party acquires 50% or more of the outstanding voting stock of the company.
- The company is a party to a merger or consolidation which results in 50% or more of the voting stock of the company being converted into securities of another entity.
- The sale or disposition of all or substantially all of the company's assets.
- A change in the composition of the board of directors within a specific period of time, resulting in fewer than a majority of the directors continuing to serve as directors.

A change in control agreement serves at least two purposes. It assures that key management personnel will be available both prior to and following the transition in the change in control of a company. Secondly, it assures key management personnel that they will be employed and

continue to have their existing authority, duties and compensation.

Employment agreements and change in control agreements generally contain provisions regarding the protection of confidential information belonging to the company, and a noncompete period prohibiting the executive from competing with the company for a specific period of time and in a specific geographic area following the termination of employment. One of the purposes of a noncompete provision is to prevent the executive from using knowledge or information acquired during his employment to compete with his former employer. In absence of a noncompete provision, the executive may be free to compete with his former employer.

A confidentiality provision merely prohibits the executive from disclosing certain private information of his employer. Confidential information generally includes business plans, nonpublic financial statements, customer lists, contracts and other proprietary information belonging to the company, but does not include information that is available to the public.

Both agreements may address termination for cause by the company for acts of the employee, such as fraud, conviction of a felony, excessive absences without approval, use of drugs or alcohol and similar conduct. At the same time, both agreements should provide protection for the executive by allowing termination for good cause, such as reduction in salary, demotion or relocation without the executive's consent. Unlike a termination for cause by the company, a termination for good cause by the employee will generally allow the executive to receive the compensation and benefits under the remaining term of the agreement had the agreement remained in force.

Both employment and change in control agreements will generally contain provisions relating to enforcement and remedies available to the company for breach by the executive. The agreements generally will provide for the rights of the company to seek monetary damages and injunctive relief for breach by the executive. Because provisions in employment and change in control agreements may result in adverse tax consequences to the parties, as well as having provisions which may be unenforceable, it is best to utilize the services of a professional to make sure that the agreements comply with applicable law.

Preemptive Rights

Preemptive rights are generally referred to as the rights of existing shareholders to maintain their percentage of ownership of a company by having the right to buy a pro rata number of shares of any future issuances of common stock. Preemptive rights are often bargained for by investors, but usually are not contained in the articles of a company.

If preemptive rights are contained in the articles of incorporation, this provision can only be eliminated by a vote of the shareholders. If a company offers more of its stock, shareholders having preemptive rights are afforded the right to buy the shares to keep their percentage of ownership the same. By having preemptive rights, shareholders can maintain their voting control and share of earnings. However, preemptive rights complicate financing. By forcing a company to offer its shares to existing shareholders before it offers the shares to outside investors, these rights can postpone or effectively eliminate the sale of shares by a company to outsiders.

Preemptive rights can also delay funding by an investor by requiring the company to

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first offer the shares to existing shareholders, creating a barrier to obtain financing by a company. Companies needing adequate financing and having to raise additional capital should consider eliminating preemptive rights if such rights exist in the articles of the company.

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