Gutierrez Severance Hinges on Reason for Leaving Kellogg

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WASHINGTON (Dow Jones) – Is an offer to run the Commerce Department a good reason to leave Kellogg Co. (K)?

The answer to that question could be worth millions of dollars to departing Chief Executive Carlos Gutierrez.

Under his employment agreement with Kellogg, Gutierrez, who was nominated by President Bush on Monday to become Commerce Secretary, is entitled to more than $8 million in severance if he's fired without cause or leaves Kellogg for "good reason." The agreement, like those that many companies have with their top executives, mentions several circumstances that would represent good reason for leaving – if Kellogg diminishes Gutierrez's power or duties, requires him to relocate, or otherwise violates terms of the contract.

But unlike many other CEOs' employment agreements, Kellogg's contract with Gutierrez gives him considerable say in deciding whether any of those scenarios have occurred. The agreement states that "any good-faith determination of good reason made by the executive shall be conclusive."

That provision is unusual, said Paul Hodgson, a senior research associate at the Corporate Library, a Portland, Maine, governance research firm. "Of the hundreds of employment contracts I've read, I don't think I recall ever seeing that," he said. Other experts didn't find the language exceptional.

Gutierrez's potential $8 million severance, part of an agreement that was filed with the Securities and Exchange Commission in August 2000, represents three times his most recent annual salary and bonus. If Gutierrez doesn't claim that his departure from the Battlecreek, Mich., cereal maker fits the "good reason" criteria, he isn't entitled to receive any severance payment.

Declined to Discuss Plans

Under the terms of Gutierrez's contract, an offer to head the Commerce Department isn't a good reason that would qualify him for the severance pay, according to compensation experts. Gutierrez, through a company spokesman, declined to discuss his plans regarding the potential severance, but experts say they doubt that he will try to snag the severance payment before joining the Bush administration, where Cabinet secretaries this year earned $175,700 salaries.

After Bush announced the nomination, Kellogg said in a press release that Gutierrez will remain CEO until he is sworn in at the Commerce Department, replacing Donald Evans. The Senate is expected to confirm Gutierrez's nomination early next year.

While acknowledging that Gutierrez is unlikely to claim that he's leaving for good reason, Hodgson said that provision giving a CEO the power to make that determination is "entirely inappropriate." The language "allows far to much leeway to the individual executive," Hodgson said.

But Joseph E. Bachelder, a New York attorney who negotiates employment agreements for high-profile executives, said an executive is unlikely to abuse the provision. If a company disagrees with the executive's assertion that he's leaving for good reason, the company can refuse to pay the severance that the executive claims he's entitled to, Bachelder said. The executives' only recourse would be to sue the company. It then would be up to a court to decide whether the executive had concluded, in good faith, that he had good reason to leave.

That outcome would be similar to what could happen at some other companies if a departing CEO and the board of directors disagreed about whether the executive had good reason to leave. For example, Pfizer Inc.'s (PFE) contract with CEO Henry McKinnell says that if the executive and the board can't settle a dispute over good reason, it will be resolved in arbitration or court. However, unlike Gutierrez's contract, McKinnell's employment agreement doesn't say that his good-faith determination of god reason will be conclusive.

When an executive decides to leave a company, "he's very vulnerable," Bachelder said. "That's what (the language in Gutierrez's contract) is intended to cure. …It does not mean the company is helpless, not at all. They still have their hands on the bank. This is intended to give the executive insurance which probably 99 times out of 100 he won't need."

Michael S. Sirkin, who heads the executive compensation practice at Proskauer Rose LLP in New York, said the provision in Gutierrez's contract is crafted to allow the CEO to leave, severance payment in hand, in case "somebody (on the board) is giving you a hard time and making you unhappy."

'Single-Trigger Provision'

"This is sort of a back-door way of giving some a 'single trigger' if you're unhappy," Sirkin said. Single-trigger provisions, sometimes found in change-of-control agreements, entitle executives to leave the company and collect severance if a specific scenario unfolds, such as an outsider gaining control of a majority of voting power in the company.

Sirkin, who described the language in Gutierrez's contract as "somewhat unusual in senior-level employment agreement," said the provision isn't likely to prove useful for many CEOs, unless they're engaged in a struggle with the board of directors. "When this really comes into play is with lower-level executives," whose job duties are more likely to be affected by corporate reorganizations, Sirkin said.

Kellogg's employment agreements with its other top two executives – President and Chief Operating Officer David Mackay and Executive Vice President Alan F. Harris – don't include similar "good-faith" language empowering them to be the arbiters of whether they're leaving for good reason.

Gutierrez may not need to cite his contract in order to get a severance package from the company.

“Obviously the board has lots of discretion in this kind of situation,” said Lucian Bebchuk, a Harvard Law School professor who runs the school’s corporate governance program.