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Problems with Contracts

Barely 3% of companies said in a survey conducted this March by the Sopot research company PBS DGA that they hire lawyers to draft their contracts.[1] Unfortunately, this also applies to contracts that companies rely on when establishing the details of executive compensation.

Pay of top managers is generally tied to the company's financial performance. Obviously, any form of executive compensation needs to have a contractual foundation. Often, however, a contract is made up of more than one simple document.

An employment contract or managerial contract is just the starting point when it comes to setting executive compensation. If compensation is also to include sharing in the profit of the company which the executive manages (or affiliates), proper drafting is required not only for the individual contracts, but other documents as well. If an element of compensation is to include a share in the profit of a limited-liability company, free shares awarded to the manager during his service on the management board may come into play, as may registered shares or options that vest over time. Then claims for a payout from the profit will be governed chiefly by the contract with the manager in conjunction with the company's articles of association.

The situation becomes more complicated when compensation is to be paid through acquisition of newly created shares, for example in connection with a public offering. Then the terms of the prospectus will be crucial, alongside the bylaws of the company bodies deciding on who is entitled to receive shares, and the contract between the issuer (the company) and the underwriter (bank or brokerage) which will sell the shares to the persons entitled to acquire them.

It is not just the issuer that can be guilty of inconsistencies or contradictions in the wording of various operative documents. Cases like this happen at professional brokerage houses, too. Then they should be liable for negligence, as the courts have held (for example, the Judgment of the Appeal Court in Warsaw of 13 February 2009, No. ACa 838/08).[2]

The responsible parties will argue, however, that an executive is not an ordinary consumer, but a member of top management with much greater knowledge about corporate law and the securities market. They claim that the manager is partially to blame because he failed to review the contracts and other documents involved in the sale of the shares, and thus his claim for damages should be limited.

If there is a discrepancy in the wording of the documents that can't be cured by the good will of the parties to the transaction, we will have years of complex litigation on our hands. Then it will be too late to revise the agreement and give the lawyer a chance to earn his fee. *Quidquid agis, prudenter agas et respice finem*: Whatever you do, do cautiously, and look to the end.

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[1] M. Bobrowicz, *Kancelaria*, May 2009, p. 25.
[2] M. Domagalski, "When an Underwriter Is Liable," *Rzeczpospolita*, 18 February 2009 (in Polish) (http://www.rp.pl/artykul/76507,264871_Za_co_odpowiada_subemitent_akcji.html).