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Employee Agreements: Enforceable Contracts for the 21st Century

By Anne DeAcetis
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It's now standard practice for new employees to sign contracts with their employers. Companies habitually provide agreements intended to protect their business, and workers (by and large) dutifully sign them. But poorly-written contracts leave companies vulnerable, and drafting them should be anything but a perfunctory process. To ensure everyone gets a "fair deal," companies must create employee agreements that are smart, relevant, and—most importantly—enforceable.

Most employers are familiar with the many "restrictive covenants" available to them. They understand the need for non-solicitation clauses that safeguard their client base. They recognize the need to protect their own proprietary information, and they quite reasonably seek to prevent departing employees from going straight to work for competitors. They are often less familiar, however, with how the details of these agreements can create risk.

Jed L. Marcus, Esq. of Bressler, Amery & Ross PC (a specialist in drafting employee contracts) visited TemPositions' HR Roundtable Series on Thursday, November 10th, 2011 to discuss the essential elements of employment contracts—and the most common mistakes employers make. One of the most simple, he explained, is overestimating the legal strength of an agreement.

"There are a lot of mistakes that are made in the formation of contracts that prevent enforcement in one way or the other," he explained. "Just because something is written on a piece of paper and an employee signs it doesn't mean a court is going to enforce it."

Employment Agreements 101

In general, employment contracts are good for everyone, Marcus began. Companies like them because they provide protection. They cut down on litigation and help guard intellectual property and/or trade secrets, and they can offer flexibility when circumstances change. Employees like them because they clarify the relationship. They outline employer expectations and how success will be measured on the job, and they often provide a clear process for resolving disputes.

As Marcus put it, contracts enable both companies and employees to "memorialize everything, so that everybody's rights and obligations—theoretically—are spelled out." But it's also critically important that the terms be fair, he noted, and that the company be prepared to

demonstrate it has something to lose if employees violate terms. Courts won't enforce policies that don't actually protect the company from losses, or those that seem unreasonable.

Most employment agreements address the following topics:

Terms of Employment

Terms for employment typically fall into three broad categories: at-will, drop-dead (also known as "no cut") and evergreen. Each has its own advantages, disadvantages and consequences.

Under an at-will agreement (common for full-time positions), either party is free to end the relationship at any time, with appropriate notice. Of course, Marcus explained, the company can't violate antidiscrimination or other worker protection laws. Reasons for termination must be legitimate and lawful.

Drop-dead contracts specify a finite term for employment—a specific number of months or years. At the end of that term, the contracts (and the relationships) expire. These contracts work well for employers who need specialized help on particular projects, and they provide employees with firm end dates for their commitments, in advance.

Evergreen contracts automatically renew upon mutual agreement of the parties. At the end of the term, if neither party voices a desire to terminate, the contract's terms continue for another employment period.

Of course, the details of these contracts are extremely important. Drop-dead contracts, for example, may seem straightforward enough. But what happens if an employee stays with the company beyond the expiration date? What are the terms...beyond the terms? "Suddenly, you're in a legal gray area," Marcus warned.

To keep on firm legal footing, employers should ensure that even the most standard contracts are detailed and thorough—and address every plausible eventuality. They should include, Marcus explained, what will happen to rights and obligations after contracts expire. The solution can be simple (companies can protect themselves by specifying that if a contract is not renewed, an employee who keeps working transition to at-will status), but the issue must be addressed.

Termination

The company may choose to terminate some employees before their contracts expire. By including a detailed termination clause, companies protect their right to dismiss workers for cause: e.g., chronic lateness or absenteeism, theft, failure to perform, or violation of company policies (Marcus recommended itemizing: harassment, anti-discrimination, etc.). Companies should also lawfully address what will happen if an employee becomes disabled.

Employees, too, have the right to terminate agreements, and acceptable reasons for leaving should be included. Workers must be permitted to exit without penalty if the company fails to pay them, demotes them or radically changes their duties. It's also reasonable to let workers leave if the company relocates to another state, or company ownership/leadership changes.

It's also wise to address employee compensation upon termination. Companies can specify that if a worker is terminated for cause, they forfeit severance. But if, for example, an employee is terminated early for reasons unrelated to performance, the company may choose to provide full-time pay through the end of the contract—and even dole out that pay on a specific schedule. Choosing what works for you and putting it in the contract, Marcus explained, is wiser than waiting for a judge to later determine what's "fair."

Those who are terminated for cause, unfortunately, have sometimes caused harm to the company. Stolen competitive information or disclosure of trade secrets can be costly. So it's advisable to include a clause protecting the company's right to actual damages or liquidated damages in such cases. (Liquidated damages are a dollar figure that represents the loss, and are usually agreed upon by the parties when actual damages are too difficult to calculate.)

Finally, there should also be a bad-faith penalty clause, Marcus counseled. This empowers arbitrators and courts to enforce additional monetary penalties—on top of actual or liquidated damages—when employees intentionally or maliciously fail/refuse to fulfill the terms of their contracts.

Job Descriptions

Job descriptions are central to employment contracts. But when drafting them, Marcus explained, there's no reason to paint the company into a corner. Identify executive positions vs. support positions accurately—but try to keep descriptions as general as possible. Define duties and responsibilities broadly and focus on the big picture, not day-to-day tasks. "What you want to avoid," he explained, "are those exclamations of, 'That's not my job!'"

Every job description should include a title, a list of core responsibilities, and expected "work effort": full-time, part-time or flex time. It should specify where the employee will work, and generally how. The description should also identify the employee's direct report(s) and greater leadership ladder, and clarify his/her position in that hierarchy.

It's also prudent to add some language governing work outside the company, Marcus noted. The company can specify that no one holding a given position can be bound by contracts with other companies or do related work for competitors (or any third party), even on a volunteer basis. If you're a hospital or a law firm, he warned, you may not want your doctors or lawyers practicing beyond your supervision when you could potentially be held liable for malpractice.

Compensation

In the compensation clause, the company specifies the employee's pay rate or salary, along with information on available benefits like medical insurance, retirement plans or stock options. It's also a good place to include details on how bonuses, raises, and other financial perks are earned. Like the job description, it clarifies expectations for the employee.

An employee's base pay is their "minimum guaranteed amount and adjustments." This number does not change regardless of performance. But employers are free to add incentive pay in the

form of bonuses, stock options or commissions. Take the time to detail how employees earn these rewards, Marcus explained, so that employees understand they are not guaranteed.

It can be highly motivating to also include information on future potential compensation. Be clear that this compensation is contingent upon the employee meeting measurable goals and performing to the highest standards—but don't keep the company's needs a secret. An employee who knows what they need to do to substantially increase their compensation is more likely to embrace those challenges.

Finally, details on severance packages should be included in this clause. But be careful, Marcus warned, of running afoul of Section 409A of the Internal Revenue Code. Designed to discourage golden parachutes, this law requires the employee to pay all taxes for deferred compensation as soon as they become eligible—even if their severance package is scheduled to be paid over an extended period. Some deferred compensation is even subject to an excise tax of 20-30%.

Most companies don't offer excessively large severance or deferred pay packages, Marcus acknowledged, but it's worth noting that there are dangers to avoid. "If you do anything unusual," he stressed, "work with a tax accountant."

Intellectual Property and Proprietary Information

Use this clause to safeguard the company's confidential information and trade secrets, Marcus recommended. They represent important aspects of your competitive advantage.

Everything the employee learns, sees and touches should be identified as the "exclusive property" of the employer. Information on company servers and the employee's work product (as well as the work product of fellow employees) should be included. A non-disclosure covenant in the clause can then specify that employees are strictly prohibited from sharing any of this information outside the company.

It can be trickier, Marcus noted, to determine who has the legal right to a "book of business," or list of clients. Some professionals travel from company to company along with their client base and/or contacts, while others make cleaner exits. You'll need to draft a policy that respects the norms in your industry and is fair for the employee.

But do draft that policy, he warned. If the employment agreement does not address book of business ownership, judges will decide—and related laws can vary widely from state to state.

Finally, determine the company's position on moonlighting, and be clear about the limits. As noted under Job Descriptions, some outside work may involve risk for the company. But other types of freelance assignments may be acceptable. Protect your own interests, Marcus noted, but be reasonable. If the employee's compensation is very low or they only work part-time, a judge may not approve of limiting their opportunities.

Non-competition following Termination

Non-compete clauses prevent current employees and exiting employees (whether terminated for cause or any other reason) from going to work for a direct competitor, within reasonable limits.

When crafting these clauses, companies must consider the following factors: scope; timeframe and geographic area(s); and employer bona fide interests.

The scope of a non-compete agreement refers to its reach—specifically in terms of professional relevance. Many companies specify that their terminated employees may not go to work for a direct competitor in the same industry. But depending on your business, it may also be harmful to allow a former employee to work for a customer or client.

Of course, it's impractical to expect employees to leave industries permanently every time they change jobs. So you'll need to consider timeframes and geographic area(s) that are appropriate. For example, a New York-based company with New York clientele may specify that a departing employee may not go to work for a direct competitor within New York State for six months.

While employers can ask workers to sign non-compete agreements, Marcus noted, courts won't enforce them if the company doesn't actually have anything to lose. So it's important to include a definition of the company's bona fide interests as part of your non-compete provision. Define customers and competitors clearly, so that a judge can understand the basis for your policy.

Enforcement becomes a serious problem when companies overreach on any of these three core components: scope, time/geographic area, or bona fide interests. When former employees sue to have non-compete agreements nullified, it's usually to protest unreasonable terms.

“Two companies maybe both be in pharmaceuticals,” Marcus offered as an example. “But if someone transitions from one company's band-aid division to another's brand-name drug division, is there really a conflict?” In such a case, a judge may well find for the plaintiff.

To get an injunction (a decision that prevents your former employee for working for your competitor), Marcus explained, you need to demonstrate that the company will suffer “irreparable harm.” Judges only grant injunctions when companies can prove that former employees have stolen clients or product/service/trade secrets. Non-competes are most enforceable, he stressed, when money alone could never resolve the issue.

Companies can also bolster enforcement by including a survival clause. A survival clause states that even if the contract expires, all obligations detailed in the non-compete survive. This is especially important when an employee continues working past the expiration date of their contract, Marcus stressed. You can and should specify that the timeframe for non-competition begins at the end of employment, not upon contract expiration.

He also urged attendees to consider a clause that essentially states, “If a court in one jurisdiction finds that any clause is unenforceable, that doesn't mean it's unenforceable in all jurisdictions.” This can be especially helpful when there are employment agreements in effect across multiple states, and when employees relocate. By including this clause, companies protect their right to keep bringing an issue to court that affects multiple states (and multi-state employees).

Finally, Marcus recommended a “Blue Pencil” provision. Blue Pencil represents a judge's ability to rewrite parts of an agreement to make it lawful. Rather than throw out your entire agreement,

he reasoned, empower the court to make small changes that keep the rest of it fully in force. A simple statement like this will suffice: “If a court finds that any aspect of this agreement is unenforceable because it violates public policy or the law, the court can rewrite the agreement.”

While allowing courts to Blue Pencil your agreements may seem risky, it’s actually quite safe. Courts don’t “change the benefits of the bargain,” Marcus explained. They override provisions that are unenforceable and replace them with alternatives that are typically measured and fair—to both parties.

Arbitration

More and more employers are now turning to alternate dispute resolution (ADR), including arbitration, to resolve conflicts—and adding arbitration agreements to their contracts. There are, of course, advantages and disadvantages to committing to a process before the facts of a case are known. But arbitration does have benefits that many employers find appealing.

Arbitration is a closed settlement process involving only an arbiter—often a judge. Both parties agree to meet behind closed doors, discuss grievances and present their positions to the arbiter, and then abide by his/her ruling. There is no jury trial, no possible press coverage and a guarantee of no public spectacle. All this is avoided with a simple clause that commits the employee to “arbitrate the universe of claims and waive rights to a jury case.”

(Some employers use a jury waiver instead of arbitration. Under a jury waiver, employees are still free to sue the company, but they waive all rights to a jury trial and agree to have a judge hear and settle/resolve the case.)

In general, Marcus explained, arbitration is “less costly and more predictable” than going to trial, and offers “a greater chance of win-win.” Because it replaces litigation, it’s much less disruptive to daily company operations and has far less effect on morale (if any). It’s far less expensive than a jury trial, and the company’s exposure to damages is limited. And courts are eager to enforce arbitration agreements, as their dockets are already clogged with cases.

Employers can also include a class action waiver. This specifies that when employees bring a claim to arbitration, they waive their right to bring that same grievance to court as part of a class action. This can be a huge cost-saver, Marcus stressed. Even if your company prevails against a class action, the defense costs are enormous. An arbitration clause with this simple waiver can discourage plaintiff’s attorneys from bringing the class action in the first place.

There are limits to how employers use arbitration. “The process remains subject to state law,” Marcus noted. Employees can’t be coerced. Arbitration must be binding for both parties, and it can’t “diminish substantive rights.” It can only be used to address breaches in the employment contract—and employers, like employees, can’t pick and choose which grievances they might like to take to court. If arbitration is the rule, then all disputes must be settled via this process.

It’s important to note that unlike other, standard employment agreement clauses (e.g., job description, compensation, etc.), the arbitration agreement must appear on its own page(s) and be individually signed.

Protective Provisions

Protective provisions ensure that the employment relationship begins with both a clean slate and clear legal expectations, Marcus explained. They're often overlooked—but shouldn't be.

At the time of hire, require employees to disclose any prior commitments—i.e., obligations to previous and/or other employers. Of course, dishonest employees may fail to acknowledge these commitments, Marcus noted. The company can afford itself some protection by including a clause that states, “I, the employee, hereby warrant and represent that I am not subject to any other employment agreement that I may be breaching by taking employment with the company.”

It's also wise to include an “integration” clause describing the process for making amendments to the contract. And because legal actions do occur, protective provisions should also include a “choice of law” clause (specifying the state laws/procedures that will apply), a clarification of legal representation (identification of the “client”) and a severability clause that details the process for dealing with any aspects of the employment agreement that prove unenforceable.

Miscellaneous Provisions

Finally, you'll want your employment agreement to address any and all loose ends. For example, having outlined a process for making amendments, the company will need to specify who is authorized to make such changes (in writing). Having provided the employee with a company handbook, the company should require the employee to acknowledge not only that they received it, but that they've read it, understand the company's policies, and agree to abide by them.

This is also a good place to address liquidated damages (if any). But, Marcus reminded attendees, liquidated damages are only relevant when the company is at risk of true financial loss that would be difficult to calculate. Companies should not specify liquidated damages without strong justification, as punitive liquidated damages are unlawful and will be dismissed.

Peter and the Wolf: A Cautionary Tale

Marcus then invited attendees to apply what they'd learned to a fun, fictional scenario: an employment relationship between a producer named Peter and a company called Wolf Insurance. Wolf, of course, asked Peter to sign an agreement upon hiring. Together, Marcus and the members of the HR Roundtable weighed the enforceability of its various provisions.

Part One: The Agreement

Wolf offered Peter a two-year agreement. Per the non-compete clause, Peter was forbidden from working for any competitor, worldwide, for two years. He was bound to confidentiality and non-solicitation. Liquidated damages were set at two years' revenue. The agreement also specified that Wolf could not assign Peter's contract to a third party, the parties were bound to arbitration, and the contract was subject to New York law (and courts).

Attendees identified several potential problems with this agreement. The duration of the non-compete clause (two years) might be found reasonable by some courts, but unreasonable by others. And the territory—the entire world—definitely seemed like overreach. Barring broad

international insurance clientele, most courts would find this restriction unfair, Marcus agreed. Many judges might be tempted to Blue Pencil the territory to enable Peter to work.

Part Two: Changing Circumstances

After 18 months, Wolf Insurance was sold to Bear Cub Insurance Broker in a stock purchase agreement. Bear Cub assumed the role of Peter's contractual employer.

Several attendees questioned whether or not this qualified as a reassignment. Per Peter's agreement, Wolf could not assign Peter's contract to a third party. But Marcus corrected them on this technical question. In a stock purchase agreement, the company stock is sold, but not its assets or property. By law, the company remains the same and employment agreements remain in effect—even when, as in this case, the buyer changes the name of the company post-sale.

Part Three: Termination

11 months later, Bear Cub terminated Peter's employment citing "economic reasons" (he was not terminated for cause). Before leaving the office, Peter downloaded information for all his professional contacts and gathered several boxes of company materials, which he took with him.

Attendees quickly identified Peter's violation of his employee agreement's confidentiality clause and intended violation of the non-solicitation clause. They also remarked upon the employer's poor handling of Peter's dismissal. An orderly termination usually includes escorting the former employee from the building and taking reasonable care to safeguard company property.

Part Four: Peter's New Position

Shortly thereafter, Peter went to work for a competitor in Philadelphia: Poacher Insurance LLC. He loaded his contacts onto his new laptop and began contacting his clients from Bear Cub.

Attendees noted that Peter was in violation of his non-compete agreement, as well as non-solicitation and confidentiality clauses.

Part Five: The Lawsuit

Bear Cub became aware of Peter's activities and filed a lawsuit in Pennsylvania to stop Peter from working for Poacher. Peter responded with a counterclaim, in which he stated that his agreement with Wolf was unenforceable and that he was terminated due to age discrimination.

First, attendees were perplexed by Bear Cub's choice of venue—Pennsylvania—when the contract specified New York. Per Marcus, Peter might be successful if he requested that the venue be changed.

Bear Cub's pursuit of an injunction was also problematic. Liquidated damages had already been set at two years' revenue. Remember, Marcus noted, judges only grant injunctions when companies can prove irreparable harm. And irreparable harm is partially defined as injury to the business that *cannot* be repaired by monetary damages.

Also, both sides had committed to arbitration to resolve disputes. This alone, Marcus explained, could result in the dismissal of both Bear Cub's injunction request and Peter's counterclaim alleging age discrimination.

And—critically—Peter's original agreement with Wolf included no survival clause. When Peter went to work for Poacher, Marcus explained, 29 months had passed on a two-year term. There was no specification that the terms of the agreement survived either the expiration of the contract or termination of employment.

That said, Marcus went on, judges in this area of the law seek fairness. If the information that Peter stole from Bear Cub was critical to the success of the business, a judge may Blue Pencil a survival clause where there once was none.

This same commitment to fairness, he went on, could also serve Peter. After all, Peter did not voluntarily leave Bear Cub. He was terminated for reasons that were unrelated to performance. Marcus posed the question this way: "Is it fair for a company to say, 'We fired a guy because we didn't have enough work for him, but now we want you to stop him from being to work for anyone else?'" Most courts would recognize and respect Peter's basic need to earn a living.

Smart Contracts, Smart Business

In closing, Marcus reassured attendees that by creating mindful agreements, most companies can avoid costly, disruptive legal struggles like the one between Peter and Bear Cub. "The object is to stay out of lawsuits, not to win them," he explained. And by keeping terms fair, including all necessary clauses and drafting agreements with enforceability in mind, employers can establish a more positive relationship with workers, generally reducing the need for dispute resolution.

"HR doesn't have to be reactive," he stressed. "This is where you use the employment agreement and your policies as risk management tools. 'How do I prevent litigation and reduce the cost of disputes?' Those are the questions you need to ask." By addressing those questions within employment agreements, he concluded, HR can keep everyone's energies focused on the success of the business—not on claims.

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