

Drafting Executive Employment Agreements That Work For Employers: An Annotated Model Agreement

.....

Peter M. Panken and Jeffery D. Williams

A. Checklist For Drafting Executive Employment Agreements That Work For Employers

1. Here are key questions and provisions that must be dealt with in executive employment contracts. These contracts are often individualized by company and by executive. The higher the level of the executive, the more intense the bargaining will be and the more individualized the contract terms will be. Nevertheless, this checklist will focus the negotiator and the drafter on the key elements of the agreement.
 - a. *Applicable Law.* Employment agreements are enforced under state law. So it is vital to understand which state law is applicable to the contract. One way is to agree that a particular state law governs, but it is necessary to select a state law that has a defensible nexus to the employment relationship.
 - b. *The Parties.* Defining the employer is key: is it a parent corporation, a subsidiary corporation, or is it both? The employer may want the ability to assign the contract to a future employer but will not want the employee to be able to assign the contract, so as to replace the executive with another individual.
 - c. *Contract Length.* Most executive employment contracts are for a specified term: one, two, three, or more years. But it is important to know whether your state law implies an automatic renewal absent a specific term in the contract and if needed to put in such a term.
 - d. *Describing Executive's Duties.* The executive's duties are most often described by the executive's title (for example, the duties of vice president of operations or controller). But flexibility is important, so

Peter M. Panken is a partner in the New York City office of Epstein Becker & Green, P.C. Jeffery D. Williams is Corporate Counsel to Pfizer Inc. in New York City. Copyright 2000, 2007 by Peter M. Panken.

the description should include “such other duties as may be assigned by the employer from time to time.” Otherwise a change in duties or title may be considered a breach of contract by the employer or “good reason” for resignation by the executive if that is permitted by the contract.

- e. *Full-Time Employment And Best Efforts.* The executive should agree to give full-time employment and best efforts. The executive might want to exclude certain extracurricular activities such as charitable work.
- f. *Conflict Of Interest And Abiding By The Rules.* The contract should specify an agreement to avoid conflicts of interest with the employer and to abide by all of the employer’s rules and regulations.
- g. *Compensation.* The contract should spell out the salary, commissions, bonuses (when and how earned, by performance or longevity), incentive compensation, stock options, deferred compensation, and so forth.
 - i. With respect to deferred compensation for key employees of public companies, it is important to be sure that Internal Revenue Code (“IRC”) §409A is complied with. Among its requirements are that deferrals must be elected prior to the beginning of the fiscal year, and severance benefits cannot be paid until at least six months after termination to specified high-level executives. There are exceptions for qualified pension and profit-sharing plans, so it is important to check with the company’s accountant to be sure all of the IRC §409A requirements are complied with. Otherwise there may be immediate income tax recognition and a 20 percent excise tax imposed on the executive.
- h. *Benefits.* Pension or profit-sharing, stock option, and severance benefit plans normally have summary plan descriptions that should be referred to in the employment contract to avoid arguments that the plans cannot be amended as to this executive alone.
 - i. Vacations, holidays, sick leave, life, disability and health insurance plans, and so forth are often left to the general employee manual but are sometimes spelled out in the executive’s contract.
 - ii. Expense account or travel and entertainment expense reimbursement might also be spelled out.
- i. *Contract Termination.* Premature termination standards should be spelled out carefully. What happens upon the death of the executive? Is there some salary continuation, or is life insurance enough?
 - i. What about disability? How do you define disability in terms of not being able to do the essential functions of the job? How long should the disability exist before the contract terminates?
 - ii. Can there be termination without cause? If so, how much does the executive receive? Is it salary to the end of the contract? Is it salary until the next job? Is it a lump sum?
 - iii. Should there be any salary continuation if the executive is terminated for “cause”? Normally there is none in this circumstance.
 - iv. Can the employer terminate the contract because of employer economic problems short of bankruptcy?

v. Can the executive terminate employment for “good reason”? If so, how do you determine good reason? The executive will want good reason to include a material change in duties, responsibilities, or reporting. Or it might also include a change of control provision. What severance pay is the executive entitled to if the executive quits for good reason?

j. *Defining Cause.* Most states have very little precedent for defining cause that would allow an employer to terminate an executive employment contract. Therefore, it is important to define “cause” in the contract. Executives will negotiate this provision fiercely, but below are some definitions that might be important for any employer of an executive.

i. The majority of courts have adopted the *Restatement (Second) of Agency* approach, which provides in pertinent part:

A principal is privileged to discharge before the time fixed by the contract of employment an agent who has committed such a violation of duty that his conduct constitutes a material breach of contract, or who without committing a violation of duty, fails to perform or reasonably appears to be unable to perform a material part of the promised service because of physical or mental disability.

Restatement (Second) of Agency §409(1) (1958).

ii. Nevertheless, it is advisable to spell out the meaning of “cause” for termination. Here are some suggestions:

- (1) Failure or neglect by employee to perform duties of the employee’s position;
- (2) Failure of employee to obey orders given by the company or supervisors;
- (3) Misconduct in connection with the performance of any of employee’s duties, including, without limitation, misappropriation of funds or property of the company, securing or attempting to secure personally any profit in connection with any transaction entered into on behalf of the company, misrepresentation to the company, or any violation of law or regulations on company premises or to which the company is subject;
- (4) Commission by employee of an act involving moral turpitude, dishonesty, theft, unethical business conduct, or conduct that impairs or injures the reputation of, or harms, the company;
- (5) Disloyalty by employee, including, without limitation, aiding a competitor;
- (6) Failure by employee to devote his or her full-time and best efforts to the company’s business and affairs;
- (7) Failure by employee to work exclusively for the company;
- (8) Misappropriation of a company opportunity;
- (9) Failure to fully cooperate in any investigation by the company;
- (10) Any breach of this agreement or company rules; or
- (11) Any other act of misconduct by employee.

k. *Noncompetition Agreements And Restrictive Covenants.* Most states (but not all) allow employers to require that an employee not compete with the former employer for a “reasonable” time (balancing the

employer's need to be protected with the ex-employee's ability to be employed) within a "reasonable" area following termination. It is important to understand the restrictions of the state whose law applies.

- i. But trade secret protection is more freely allowed as are prohibitions against soliciting employees to leave their employment for a reasonable period following termination.
 - ii. It is important to spell out the employer's ability to get injunctive relief against a breach of these provisions.
- l. *Representations That Employment Will Not Violate Agreements With Former Employers.* No employer should buy a lawsuit by employing an executive who is bound by a restrictive agreement from his or her last employment. Executives should represent that they are free of such restrictions.
 - m. *Intellectual Property.* It is important to spell out who owns the inventions, copyrights, or trademarks an executive or scientific employee produces while employed.
 - n. *Dispute Resolution.* If there is a dispute, will it be settled by arbitration or in court, and where will the venue be? Even if arbitration is the preferred venue, the employer may want to be able to go to court to get injunctive relief against violations of the restrictive covenant rules.
 - o. *Conclusion.* Every employment contract is tailored to the specific terms agreed to by the parties. The foregoing issues must be dealt with when structuring a deal with an executive with the goal of providing the utmost protection for the employer. In negotiating with a new chief executive, the more attractive the candidate the more the employer will be willing to compromise.

B. Drafting The Employment Agreement

1. The terms of a contract should be in writing understandable by and understood by the parties. This outline discusses drafting considerations and offers representative terms and clauses that might be used in drafting effective executive employment contracts.

2. Preamble: Establishing Essential Elements

- a. Employment agreements are contracts that establish a legal relationship between an employer and an employee who enter into an employment relationship. The essential elements of a contract are: (1) offer; (2) acceptance; and (3) consideration. The preamble or preliminary statement at the beginning of the employment agreement establishes contract essentials and the parties' mutual assent to the terms of the agreement:

EMPLOYMENT AGREEMENT ("Agreement") made and entered into as of June 1, 1997, by and between SHOW ME THE MONEY, INC. (the "Company"), a New York Corporation with an address at _____, and JERRY MCGUIRE ("Employee"), residing at _____.

WHEREAS, the Company desires to retain the services of Employee as Vice President of the Company; and

WHEREAS, the Company and the Employee desire to enter into this Agreement to set forth the terms and conditions of the employment relationship between the Company and the Employee;

NOW, THEREFORE, in consideration of the mutual covenants and agreements contained herein, and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties agree as follows:....

3. Term: Avoiding Automatic Renewal

- a. The purpose of a clause establishing the term of employment is to define the beginning and, more importantly, the end of the employment relationship. This can be a trap for unwary employers who fail to expressly provide for termination of the employment relationship on a date certain “*unless extended in writing by both the Company and Employee.*”
- b. This qualifying language is essential because employment agreements do not necessarily expire on the termination date. Under common law, if an employee hired for a specified term of one year or more continues to work in the same job after the term expires, the employment contract is presumed to extend for successive one year terms. 1 *Williston on Contracts* §4:23, at 691-700 (Thomson/West, 4th ed. 2007); *see also* 1 *Corbin on Contracts* §4.2, at 556 (West 1993).
- c. This common law rule is valid today and has been upheld in New York and other states, including California and Maryland. *See, e.g., Otten v. San Francisco Hotel Owners Ass’n*, 74 Cal.App.2d 341, 168 P.2d 739 (1946); *Kropfelder v. Snap-On Tools Corp.*, 859 F.Supp. 952 (D.Md. 1994); *Cinefot Int’l Corp. v. Hudson Photographic Indus.*, 13 N.Y.2d 249, 196 N.E.2d 54, 246 N.Y.S.2d 395 (1963); *see also* 27 Am.Jur.2d *Employ. Relationship* §31 (2004).
- d. The presumption of automatic renewal may be overcome by proof the parties intended otherwise; or proof of a new agreement. The following provision expressly states the parties’ mutual intention to end the employment relationship at the close of the employment term:

Term. Employee’s term of employment (the “Employment Term”) under this Agreement shall be two (2) years, commencing on June 1, 1997, and shall continue for a period through and including June 1, 1999, and shall expire after June 1, 1999, unless extended in writing by both the Company and Employee or earlier terminated pursuant to the terms and conditions set forth in this Agreement.

4. Employment Duties: Reserve Right To Reassign And Require Compliance With Company Rules And Policies

- a. Many employees only want to do particular tasks (for example, the duties of an executive). Employers will most often want to retain flexibility to use the employee where needed, especially if conditions change during the term of employment. The employer and employee should understand and agree on the duties the employee will be responsible for performing. The description of job duties could be specific but may be broadly stated so as to permit the employer to reassign the employee to another position with different responsibilities. This may become a matter of intense negotiation.
- b. A general statement of duties and the right to reassign may avoid constructive discharge or breach of contract claims resulting from a change of duties or position. A reduction in rank or change of duties the employee is engaged to perform may be a violation of an employment contract, which is specifically drawn as to duties, and the basis of an action for damages for breach of contract.

- c. Significantly, an employee's refusal to perform assignments, amounting to a reduction in rank or change of duties, in defense of his or her contractual rights, may not constitute insubordination in some states. The employee's refusal to perform duties contemplated or expressly required in the employment agreement, on the other hand, may constitute insubordination, violate the employee's contractual duty, and justify discharge without liability to the employer. *See* David J. Oliveiri, Annotation, *Reduction in Rank or Authority or Change of Duties as Breach of Employment Contract*, 63 A.L.R.3d 539 (1975) (collecting cases).
- d. In any event, the description of job duties should also include abiding by the employer's rules and policies as part of the employee's responsibilities. An appropriate duties provision might read as follows:

Duties. Employee shall perform all duties incident to the position of Vice President, as well as any other duties as may from time to time be assigned by the President of the Company or his or her designee, and agrees to abide by all bylaws, policies, practices, procedures, or rules of the Company. Employee may be reassigned or transferred to another management position, as designated by the President of the Company, which may or may not provide the same level of responsibility as the initial assignment, in accordance with the terms and conditions of this Agreement.

5. Conflicts Of Interest And Best Efforts

- a. Employers want assurance that their employees are not distracted from maximal performance because they are "moonlighting" in other jobs, or involved in any other activities, that detract from their ability to devote their time and energies to the employer or may be detrimental to the employer's business and reputation. Employers want assurance that their employees are giving their best effort. After all, the employer hired them to do the job well, not just go through the motions.
- b. Employers should carefully consider the impact of state laws on their ability to limit the off-duty activities of an employee. At least 28 states and the District of Columbia have statutes that forbid employment discrimination on the basis of off-duty tobacco use.
- c. New York state, in particular, has a "legal activities" law that prohibits adverse employment actions based on an employee's legal, off-duty recreational and political activities and use of consumable products such as tobacco. N.Y.Lab. Law §201-d (McKinney Supp. 2000). Colorado and North Dakota also attempt to protect "legal activities" of employees. Colo.Rev.Stat. §24-34-402.5; N.D.Cent. Code §14-02.403. Employers and their legal counsel should consult these laws to determine their applicability before drafting a conflicts of interest and best efforts clause.
- d. Additionally, employers may use this provision to emphasize the fiduciary duty that high-ranking employees with decision-making authority owe the employer. An important element of this fiduciary duty is the duty not to take personal advantage of potential business or so-called corporate opportunities and to present those opportunities to the employer. *See* Steven H. Winterbauer, *The Corporate Opportunity Doctrine: What Employers Should Know*, 18 Emp. Rel. L. J. 391 (1992).
- e. An appropriate clause that accomplishes these ends might read:

Exclusive Services and Best Efforts. Employee agrees to devote his or her best efforts, energies, and skill to the discharge of the duties and responsibilities attributable to his or her position, and to this end will devote his or her full time and attention exclusively to the business and affairs of the Company. Employee also agrees that he or she shall not take

personal advantage of any business opportunities that arise during employment that may benefit the Company. All material facts regarding such opportunities must be promptly reported to the President for consideration by the Company.

6. Employee Compensation And Benefits

a. Compensation

The employment agreement should definitively state how much and when the employee will be paid. State law will have to be consulted to see whether salary may be paid by direct deposit or check and how often salary must be paid. The easiest method of accomplishing this is to provide for salary payments in accordance with the employer's regular payroll practices:

Base Salary. During the Employment Term, the Company shall pay the Employee a salary at the rate of \$215,000 per annum, payable in equal installments at such payment intervals as are the usual custom of the Company, but not less often than monthly.

b. Bonuses

i. Bonuses come in many varieties, including a sign-up bonus, a regular periodic or annual bonus, a stay bonus, and an incentive bonus. The key is to make the determination to pay and the amount of any bonus subject to the employer's sole discretion. Statements that the employer will exercise its discretion "in good faith" should be avoided because they lead to costly litigation to interpret the meaning of "in good faith." The best bonus provisions simply provide that the employee may be eligible for additional compensation as determined by the employer:

Bonus. Employee shall be entitled to receive a bonus and/or other incentive compensation in an amount to be determined by the Company; provided, however, that the failure of the Company to award any such bonus and/or other incentive compensation shall not give rise to any claim against the Company. The amount, if any, and timing of such bonus shall be determined by the Company in its sole discretion.

ii. Many companies have executive bonus plans. The contract should spell out whether the employee is to benefit from such plans:

Employee shall be eligible to participate in the Company Executive Incentive Plan on the same basis as other Vice Presidents and pursuant to the terms of the plan in effect on the date eligibility for a bonus is determined.

c. Employee Benefits

i. The employment agreement should make the employee aware of benefit plans available from the employer.

ii. Employee benefit programs, such as health and life insurance, and 401(k) and pension plans, are subject to frequent modifications and change of providers. Therefore, the most efficient way to address this issue in an employment agreement is to offer the employee the same benefits in effect for other executive-level employees. This avoids the necessity of amending the employment agreement every time there is a change in an employee benefit plan:

Benefit Plans. During the Employment Term, and as otherwise provided herein, Employee shall be entitled to participate in any and all employee welfare and health benefit plans (including, but not limited to, life insurance, health and

medical, dental, and disability plans) and other employee benefit plans, including, but not limited to, qualified pension plans, established by the Company from time to time for the benefit of all executives of the Company. Employee shall be required to comply with the conditions attendant to coverage by such plans and shall comply with and be entitled to benefits only in accordance with the terms and conditions of such plans as they may be amended from time to time. Nothing herein contained shall be construed as requiring the Company to establish or continue any particular benefit plan in discharge of its obligations under this Employment Agreement.

d. Vacation And Expenses

The employment agreement may refer to the employer's practice for other executive-level employees, but it is preferable to state how much vacation the employee is eligible for, when it may be taken, and whether the employee will be paid for unused vacation. The employment agreement should also specify the business-related expenses that will be reimbursed to the employee:

Vacation and Other Benefits. The Employee shall be entitled to not less than five (5) weeks of paid vacation each year of his or her employment hereunder, as well as to such other employment benefits extended or provided to executives of comparable status, including, but not limited to, payment or reimbursement of all reasonable, ordinary, and necessary business expenses incurred by the Employee in the performance of his or her responsibilities and the promotion of the Company's businesses, including, without limitation, first-class air travel and lodging, an automobile and related expenses, cellular phone charges, one club membership and dues, and travel expenses of the Employee's spouse when accompanying him or her on business-related trips. The Employee shall submit to the Company periodic statements of all expenses so incurred. Subject to such audits as the Company may deem necessary, the Company shall reimburse the Employee the full amount of any such expenses advanced by him or her in the ordinary course of business.

e. Withholding From Salary And Benefits. Paid time off benefits should be taken in the year earned or the following year, but are not available thereafter.

i. The employment agreement should provide for deductions from salary and benefits for applicable federal, state, and local taxes and required employee contributions to benefit plans.

ii. Most states limit the deductions employers may take from an employee's pay. Deducting employee debts, advances, or loans may also be problematic in some states. In New York, for example, other than under very limited circumstances, the Department of Labor disallows such deductions from salaries. N.Y.Lab. Law §193.

Deductions from Salary and Benefits. The Company may withhold from any salary or benefits payable to Employee all federal, state, local, and other taxes and other amounts as permitted or required pursuant to law, rule, or regulation.

7. Termination Of The Employment Agreement

a. Death

i. The employment agreement should state the obvious: the contract terminates upon death of the employee. This is important so that the employee's estate does not claim it is entitled to compensation, with the exception of accrued salary, benefits, and life insurance proceeds.

Death. The Employment Term shall terminate on the date of Employee's death, in which event Employee's salary and benefits and reimbursable expenses owing to Employee through the date of Employee's death shall be paid to his or her estate. Employee's estate will not be entitled to any other compensation under this Agreement.

b. Disability

i. The employment agreement should anticipate that the employee may be unable to perform his or her responsibilities because of a disability. The employment agreement, however, does not supersede the employer's obligations under the Americans with Disabilities Act ("ADA") (42 U.S.C. §12101 *et seq.*) and the Family and Medical Leave Act ("FMLA") (29 U.S.C. §2611 *et seq.*), which must be carefully considered in dealing with employees with disabilities.

ii. In general, the ADA prohibits discrimination against a person with a disability (real or perceived) who can perform the essential functions of the job with or without reasonable accommodation.

iii. The FMLA mandates 12 weeks of unpaid leave for eligible employees in any 12-month period, including medical leave for the employee's serious health conditions and restoration to the employee's former position on completion of the leave. The FMLA contains a limited exception for highly compensated employees. The employer may deny reinstatement to an employee (upon written notice to the employee) who is in the highest paid 10% of the employer's work force if returning the employee to work would cause "substantial and grievous economic injury" to the employer's business.

iv. ADA and FMLA requirements, in addition to applicable state and local laws, should be consulted before the employer exercises its rights under the disability termination provision of the employment agreement:

Disability. If, during the Employment Term, in the opinion of the Employer, Employee, because of physical or mental illness or incapacity, shall become unable to perform substantially all of the duties and services required of him or her under this Agreement for a period of sixty (60) days in the aggregate during any 12-month period, the Company may, upon at least ten (10) days' prior written notice given at any time after the expiration of such sixty (60) day period, notify Employee of its intention to terminate this Agreement as of the date set forth in the notice. In case of such termination, Employee shall be entitled to receive salary, benefits, and reimbursable expenses owing to Employee through the date of termination. The Company shall have no further obligation or liability to Employee.

c. Notice (Without Cause)

i. Most employment agreements reserve the right of either party to terminate the employment relationship after a specified notice period. The notice termination provision should expressly provide for the termination of the employer's obligations (except for accrued salary, benefits, and reimbursable expenses) and the continuation of the employee's obligation to comply with any non-compete clause or other restrictive covenant.

ii. It is particularly difficult to enforce noncompetition clauses and other restrictive covenants when the employer terminates the employee's services. Therefore, many employment agreements provide additional consideration for the employee's compliance. Severance payments may also

serve as consideration for a waiver and release of the employee's claims against the employer arising out of the employment relationship or the termination of employment:

Termination Without Cause

(a) *Either party may terminate this Agreement without cause upon thirty (30) days written notice. Upon such termination, the Company shall be released from any and all further obligations under this Agreement, except that the Company shall be obligated to pay Employee his or her salary and benefits owing to Employee through the day on which Employee's employment is terminated. Employee's obligations under Paragraphs _____ [noncompetition and confidential information provisions] shall continue pursuant to the terms and conditions of this Agreement.*

(b) *If the Company terminates this Agreement without cause as provided in subparagraph (a) above, Employee shall receive the equivalent of three (3) months of Employee's annual salary, less deductions required by law, payable on a monthly basis, if, and only if, Employee signs a valid general release of all claims against the Company in a form provided by the Company.*

d. Termination For Cause

i. Employment agreements often specify "cause" for discharge to avoid uncertainty over the circumstances under which the employer, employee, or both may terminate an employment agreement without continuing liability for the balance of the agreement's terms.

ii. If the parties to the employment agreement do not specify what constitutes cause, the decision will be left to the court if one party believes the other has done something inimical to its contractual obligations. The majority of courts have adopted the *Restatement (Second) of Agency* approach, which provides in pertinent part:

A principal is privileged to discharge before the time fixed by the contract of employment an agent who has committed such a violation of duty that his or her conduct constitutes a material breach of contract or who without committing a violation of duty fails to perform or reasonably appears to be unable to perform a material part of the promised service because of physical or mental disability.

Restatement (Second) of Agency §409(1) (1958); see Gary Trachten, *Formal Employment Contracts: Wrongful Termination Claims*, 558 *Prac. Law Inst./Lit.* 87 (Jan. 1997) (discussing "cause" standard in employment agreements).

iii. Employers must specify what conduct constitutes "cause" to avoid the vagaries of a court decision under this ambiguous standard. Significantly, many courts require good faith and fairness as an essential component of "cause" even though the employment agreement may not. The list of specific grounds for termination should include a provision that "cause" includes any unforeseen circumstance that amounts to a breach of duty, contractual or otherwise, that the employee owes to the employer:

For Cause. (a) The Company may terminate this Agreement for cause. Upon such termination, the Company shall be released from any and all further obligations under this Agreement, except for accrued salary and benefits owing to Employee through the Termination Date. Employee's obligations under Paragraphs _____ [noncompetition and confidential information provisions] shall continue pursuant to the terms and conditions of this Agreement.

(b) *For the purposes of this Agreement, "cause" shall include, without limitation, the following:*

- (1) *failure or neglect by Employee to perform the duties of the Employee's position;*
- (2) *failure of Employee to obey orders given by the Company or supervisors;*
- (3) *misconduct in connection with the performance of any of Employee's duties, including, without limitation, misappropriation of funds or property of the Company, securing or attempting to secure personally any profit in connection with any transaction entered into on behalf of the Company, misrepresentation to the Company, or any violation of law or regulations on Company premises or to which the Company is subject;*
- (4) *commission by Employee of an act involving moral turpitude, dishonesty, theft or unethical business conduct, or conduct that impairs or injures the reputation of, or harms, the Company;*
- (5) *disloyalty by Employee, including, without limitation, aiding a competitor;*
- (6) *failure by Employee to devote his or her full-time and best efforts to the Company's business and affairs;*
- (7) *failure by Employee to work exclusively for the Company;*
- (8) *failure to fully cooperate in any investigation by the Company;*
- (9) *any breach of this Agreement or Company rules; or*
- (10) *any other act of misconduct by Employee.*

8. Noncompetition Agreements And Restrictive Covenants

- a. Every employer dreads the prospect of a trusted, executive-level employee departing to work for a competitor or to start his or her own competing business. A well-drafted noncompetition provision is an important method of limiting the business disruption and loss that may result with the departure of an employee. Such a provision should include agreements by the departing employee: (i) not to compete either during or for a specified time period after employment; (ii) not to induce other employees to leave the employer; and (iii) not to divulge the employer's trade secrets or confidential information.
- b. The enforceability of noncompete agreements and restrictive employment covenants are matters of state law. Some states, including Montana and North Dakota, prohibit covenants that restrain employees from engaging in a lawful profession, trade, or business. Mont. Code Ann. §28-2-703; N.D.Cent. Code §9-08-06. California is well known for its Code and case law purporting to hold noncompete agreements void and unenforceable; however, limited restraints on departing employees may be enforceable. *See* Richard R. Mainland, *Contracts Limiting Competition by Former Employees: A California Perspective*, 340 Prac. Law Inst./Pat. 119 (1992).
- c. Other states, including Louisiana and South Dakota, void any covenant extending more than two years after the employment relationship ends. La.Rev.Stat.Ann. §23:921(C); S.D. Codified Laws Ann. §53-9-11.
- d. Still other states, notably New York, do not have specific statutes but determine the enforceability of noncompetition agreements by balancing the respective interests of the employee (in making a living) and the employer (in protecting its business interests), focusing on public policy disfavoring competitive restrictions.

- e. The standards for enforcement of confidentiality and trade secret provisions are equally varied. For example, California and 46 other jurisdictions (including the District of Columbia) have adopted all or portions of the Uniform Trade Secrets Act as amended and approved by the National Conference of Commissioners on Uniform State Laws in 1985. New York, on the other hand, is among the states that have relied on the definition and formulation of trade secrets and confidential information contained in the *Restatement of Torts* §757 cmt. b (1939).
- f. Employers and their legal counsel may wish to consult the following sources for preparing enforceable noncompetition agreements and restrictive employment covenants. Brian M. Malsberger, *Covenants Not to Compete: A State-by-State Survey*, (BNA 6th ed. 2008); Victoria Cundiff, *The Departing Employee Toolbox: How to Construct Contracts that Meet Real Business Needs*, 20 Emp. Rel.L.J. 481 (1994); Schneider and Arnold, *Trade Secrets and the Peripatetic Employee*, 196 Prac. Law Inst./Pat. 237 (1985); James F. McKinney, *Noncompetition Clauses in Executive Employment and Severance Agreements*, 16 Emp. Rel.L.J. 29 (Summer 1990).
- g. Despite these differences, it is universally true that noncompetition and confidentiality provisions that are drafted with a particular employee's duties in mind, and are carefully tailored to protect the employer's legitimate business interests, are the most likely to be enforced in court. Blanket use of boilerplate language obscures the interests the employer is entitled to protect. Even worse, it could leave the employee seriously confused about what information is subject to protection, or cause a court to conclude that the employer is overreaching and deny enforcement of the provision. Even if state law and the employment agreement permit the court to modify or "blue pencil" the provision so that it is enforceable, it is still best to try to limit restrictions to a reasonable range.
- h. The following provides a good foundation for constructing noncompete agreements and restrictive covenants that will meet the employer's unique needs, but, as indicated above, the "noncompetition" provision is quite broad and it might well be preferable to attempt to limit the competition period in time, geographic area, or business type.

Noncompetition and Confidential Information. Employee acknowledges that his or her position with the Company is special, unique, and intellectual in character and his or her position in the Company will place him or her in a position of confidence and trust with employees and clients of the Company.

Noncompetition. Employee agrees that during the Term and for a period of one (1) year thereafter Employee will not directly or indirectly: (i) (whether as director, officer, consultant, principal, employee, agent, or otherwise) engage in or contribute Employee's knowledge and abilities to any business or entity in competition with the Company; (ii) employ or attempt to employ or assist anyone in employing any person who is an employee of the Company or was an employee of the Company during the previous one-year period; or (iii) attempt in any manner to solicit from any client business of the type performed by the Company or persuade any client of the Company to cease doing business or reduce the amount of business that such client has customarily done with the Company.

Confidentiality. Employee acknowledges that Employee will have access to certain proprietary and confidential information of the Company and its clients including, but not limited to, contemplated new products and services, marketing and advertising campaigns, sales projections, creative campaigns and themes, and financial information of the Company. Employee agrees not to use or disclose any confidential information during the Term of this Agreement

or thereafter other than in connection with performing Employee's services for the Company in accordance with this Agreement.

Enforcement. (a) Employee agrees that the restrictions set forth in this paragraph are reasonable and necessary to protect the goodwill of the Company. If any of the covenants set forth herein are deemed to be invalid or unenforceable based on the duration or otherwise, the parties contemplate that such provisions shall be modified to make them enforceable to the fullest extent permitted by law.

(b) In the event of a breach or threatened breach by Employee of the provisions set forth in this paragraph, Employee acknowledges that the Company will be irreparably harmed and that monetary damages shall be an insufficient remedy to the Company. Therefore, Employee consents to enforcement of this paragraph by means of temporary or permanent injunction and other appropriate equitable relief in any competent court, in addition to any other remedies the Company may have under this Agreement or otherwise.

9. Inventions And Improvements

- a. Employment agreements for employees such as writers, architects, engineers, or designers should include a provision making any invention or discovery conceived by the employee the employer's property and require the employee to cooperate in securing the employer's property right to the invention, discovery, or writing—e.g., patent, copyright, or trademark.
- b. The potential for an employer overreaching is a problem here as well. Several states including California, Minnesota, and Washington have laws prohibiting employment contracts that require employees to sign over their inventions and discoveries in areas outside the employer's business interests. Cal.Lab. Code §2870; Minn.Stat. Ann. §181.78; Wash.Rev. Code §49.44.140.
- c. The following clause provides a foundation for addressing intellectual property issues presented by inventive employees:

Intellectual Property

(a) The Employer has hired Employee to work full time so that anything Employee produces during the Employment Term is the property of the Company. Any writing, invention, design, system, process, development, or discovery conceived, developed, created, or made by Employee, alone or with others, during the period of his or her employment hereunder and applicable to the business of the Company, whether or not patentable, registerable, or copyrightable shall become the sole and exclusive property of the Company.

(b) Employee shall disclose the same promptly and completely to the Company and shall, during the period of his or her employment hereunder and at any time and from time to time hereafter, (i) execute all documents requested by the Company for vesting in the Company the entire right, title, and interest in and to the same, (ii) execute all documents requested by the Company for filing such applications for and procuring patents, trademarks, service marks, or copyrights as the Company, in its sole discretion, may desire to prosecute, and (iii) give the Company all assistance it may reasonably require, including the giving of testimony in any suit, action, investigation, or other proceeding, to obtain, maintain, and protect the Company's right therein and thereto.

10. Protection Against Employee's Obligations To Former Employers

- a. The employee's former employers may be just as concerned about protecting their confidential information and other legitimate business interests as employers are about protecting theirs. The

following clause will remind the employee about his or her obligations, if any, and potentially avoid costly and damaging litigation if the new employer improperly, albeit unknowingly, benefited from the former employer's confidential information:

Representations and Warranties of Employee. Employee hereby represents and warrants to the Company as follows: (i) Employee has the legal capacity and unrestricted right to execute and deliver this Agreement and to perform all of his or her obligations hereunder; (ii) the execution and delivery of this Agreement by Employee and the performance of his or her obligations hereunder will not violate or be in conflict with any fiduciary or other duty, instrument, agreement, document, arrangement, or other understanding to which Employee is a party or by which he or she is or may be bound or subject; and (iii) Employee is not a party to any instrument, agreement, document, arrangement, or other understanding with any person (other than the Company) requiring or restricting the use or disclosure of any confidential information or the provision of any employment, consulting, or other services.

11. Employee's Post-Employment Duties

- a. The employer should require the employee to return all the employer's property and business-related materials prepared by the employee when the employment relationship ends.
- b. The employer should also require the employee to make himself or herself available for any litigation the employer may become involved in that would require information from the employee:

Post-Employment Obligations

(a) Company Property. All records, files, lists, including computer generated lists, drawings, documents, equipment, and similar items relating to the Company's business that Employee shall prepare or receive from the Company shall remain the Company's sole and exclusive property. Upon termination of this Agreement, Employee shall promptly return to the Company all property of the Company in his or her possession. Employee further represents that he or she will not copy or cause to be copied, print out, or cause to be printed out any software, documents, or other materials originating with or belonging to the Company. Employee additionally represents that, upon termination of employment with the Company, he or she will not retain in his or her possession any such software, documents, or other materials.

(b) Cooperation. Employee agrees that both during and after employment he or she shall, at the request of the Company, render all assistance and perform all lawful acts that the Company considers necessary or advisable in connection with any litigation involving the Company or any director, officer, employee, shareholder, agent, representative, consultant, client, or vendor of the Company.

12. Alternative Dispute Resolution—Arbitration

- a. Many employers include arbitration provisions in their employment agreements, requiring employees to submit any employment dispute that may arise to arbitration.
- b. Arbitration is an attractive alternative to the present system of protracted and expensive litigation of employment disputes. Now that most discrimination claims are jury trials, employers are rightly concerned that runaway jurors might not understand business needs and impose their own standards where they disagree with the employer's judgments. As a result, many employers are imposing alternative dispute mechanisms for resolution of employee disputes, especially those involving claims of violations of law (statutory, contractual, or tort).

- c. Since the U.S. Supreme Court's decision in *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991), the overwhelming majority of courts have upheld the enforceability of written arbitration agreements, requiring submission of employment disputes to arbitration under the Federal Arbitration Act ("FAA"), 9 U.S.C. §1 *et seq.*
- d. The FAA established a strong federal policy favoring arbitration that extends to discrimination as well as other employment claims. But potential plaintiffs still seek to avoid arbitration and invoke juries. Enforcement of arbitration agreements is subject to defenses that apply to contracts in general, including unconscionability, fraud, and lack of consideration. Some courts have refused to enforce arbitration agreements where the individual seeking a jury trial signed an agreement without knowing its terms. *See, e.g., Prudential Ins. Co. v. Lai*, 42 F.3d 1299 (9th Cir. 1994), *cert denied*, 516 U.S. 812 (1995) (plaintiff's claim of sex discrimination and sexual harassment held not subject to arbitration where she did not knowingly enter agreement to arbitrate employment disputes); *Gibson v. Neighborhood Health Clinics*, 121 F.3d 1126, 1129 (7th Cir. 1997) ("Title VII plaintiff may only be forced to forego...statutory remedies and arbitrate a claim if she has knowingly agreed to submit such disputes to arbitration"). *But see Desiderio v. Nat'l Ass'n of Securities Dealers, Inc.*, 191 F.3d 198 (2d Cir. 1999), *cert. denied*, 531 U.S. 1069 (2001) (predispute agreement requiring compulsory arbitration of employment disputes enforceable as to Title VII claims under *Gilmer* analysis).
- e. Further, the Equal Employment Opportunity Commission ("EEOC") with its backlog of 70,000 cases (down from 120,000) has reacted adversely to agreements to submit Title VII, Age Discrimination in Employment Act, and ADA claims to arbitration unless the agreements are made after the claim arose. On July 17, 1995, the EEOC issued the *EEOC Policy Statement on Alternative Dispute Resolution*, 137 Daily Lab.Rep. (BNA) d23 (July 18, 1995), outlining voluntary arbitration procedures. The watchwords are "voluntariness," "fairness," "neutrality," and "confidentiality." But what the EEOC is promoting looks more like mediation than binding arbitration. The EEOC unequivocally stated its position against compulsory arbitration agreements by issuing its *Policy Statement on Mandatory Binding Arbitration of Employment Discrimination Disputes as a Condition of Employment*, EEOC Notice, No. 915.002 (July 10, 1997).
- f. Therefore, if an employer favors arbitration, it is imperative that the employer clearly and unambiguously require binding arbitration of all disputes in any way relating to the employment relationship or the termination of that relationship. Arbitration clauses are generally enforceable in court so long as the procedure is fair, the outcome can be the same as a jury trial, and the employee knew he or she was agreeing to final and binding arbitration:

Arbitration. Any and all disputes arising under or relating to the interpretation or application of this Agreement or concerning Employee's employment with the Company or termination thereof shall be subject to arbitration in New York, New York, under the then existing rules of the American Arbitration Association. Judgment upon the award rendered may be entered in any court of competent jurisdiction. The cost of such arbitration shall be borne equally by the parties. Nothing contained in this Paragraph shall limit the right of the Company to enforce by court injunction or other equitable relief the Employee's obligations under Paragraph ___ [noncompetition and confidential information provisions] of this Agreement.

13. Applicable Law

- a. Employers should specify the state law that will be applicable to resolving disputes under the employment agreement. Choice of law provisions in written employment agreements are routinely upheld by courts if there is a nexus to the employment relationship. *See State Labor Law Developments*, 8 Lab. Law. 618 (Summer 1992) (and supplements collecting cases).
- b. If the employment agreement does not specify the laws of a particular state, the courts will apply choice of law rules to determine which state law controls and could potentially defeat the employer's ability to enforce the employment agreement—particularly the noncompetition and confidential information provisions.
- c. Therefore, employers and their counsel should specify the applicable state laws with full enforcement of the employment agreement in mind:

Governing Law. This Agreement shall be governed by, construed, and enforced in accordance with the laws of the state of New York, without regard to the conflicts of law rules thereof.

14. Judicial Forum

- a. Employers should use the employment agreement to select a judicial forum for litigation of disputes concerning the interpretation of the agreement and enforcement of the noncompetition provision and restrictive employment covenants.
- b. The forum should be conveniently located for the employer and offer familiar court rules and procedures to the employer's legal counsel. A convenient and familiar forum allows counsel to expedite court injunctive proceedings to prevent disclosure of trade secrets or confidential information, or breach of other restrictive employment covenants:

Jurisdiction. Each of the parties hereto hereby irrevocably consents and submits to the jurisdiction of the Supreme Court of the State of New York, in New York County, and of the United States District Court for the Southern District of New York in connection with any suit, action, or other proceeding concerning the interpretation of this Agreement or enforcement of Paragraph __ [noncompetition and confidential information provisions] of this Agreement. Employee waives and agrees not to assert any defense that the court lacks jurisdiction, venue is improper, inconvenient forum, or otherwise. Employee waives the right to a jury trial and agrees to accept service of process by certified mail at Employee's last known address.

15. Assignment

- a. The employer should reserve the right to assign the employment agreement so that a successor employer may benefit from the employee's services in the event of a merger, consolidation, asset purchase, or other business transaction. The employment agreement should not be assignable by the employee, however, because the employee's unique ability to do the job is not transferable:

Successors and Assigns. Neither this Agreement nor any of Employee's rights, powers, duties, or obligations hereunder may be assigned by Employee. This Agreement shall be binding upon and inure to the benefit of Employee and his or her heirs and legal representatives and the Company and its successors. Successors of the Company shall include, without limitation, any company or companies acquiring, directly or indirectly, all or substantially all of the assets of the Company, whether by merger, consolidation, purchase, lease, or otherwise, and such successor shall thereafter be deemed "the Company" for the purpose hereof.

Note that some executives may well want an option to terminate their employment if a successor employer comes into the picture.

16. Non-Waiver Of Rights

- a. Panken's first principle of employee relations states, "No good deed goes unpunished." The non-waiver provision of the employment agreement should be drafted with that principle in mind.
- b. The non-waiver clause prevents the employee from arguing that the employer's past actions or inactions under the employment agreement bind the employer or limit the employer's ability to exercise its rights in the future. Essentially, this provision permits the employer to exercise its rights under the employment agreement without regard to whether the employer has or has not previously done so:

Waiver. Any waiver or consent from the Company with respect to any term or provision of this Agreement or any other aspect of Employee's conduct or employment shall be effective only in the specific instance and for the specific purpose for which given and shall not be deemed, regardless of frequency given, to be a further or continuing waiver or consent. The failure or delay of the Company at any time or times to require performance of, or to exercise any of its powers, rights or remedies with respect to any term or provision of this Agreement or any other aspect of Employee's conduct or employment in no manner (except as otherwise expressly provided herein) shall affect the Company's right at a later time to enforce any such term or provision.

17. Notices

- a. The employment agreement should provide addresses so that the employer and employee may send written communications concerning the agreement to the other. This provision should also state when written notice is effective (for example, upon mailing or personal delivery) for triggering termination on notice or other contract requirements:

Notices. All notices, requests, demands, and other communications hereunder must be in writing and shall be deemed to have been duly given if delivered by hand or mailed within the continental United States by first-class, registered mail, return-receipt requested, postage and registry fees prepaid, to the applicable party and addressed as follows:

The Company:

President and Chief Executive Officer

Show Me The Money, Inc.

Employee:

Jerry McGuire

(Addresses may be changed by notice in writing signed by the addressee.)

18. Modifications

Amendments to the employment agreement should be in writing and signed by the parties. This clause prevents entanglements that result when a party claims a contract was modified by an oral agreement or understanding:

Amendment. No amendment or modification of this Agreement shall be valid or effective unless in writing and signed by the parties to this Agreement.

19. Complete Agreement

- a. This provision accomplishes two goals. First, it establishes that the written employment agreement is the only contract between the parties. This is particularly significant if the parties were involved in negotiations concerning the agreement's terms. It prevents misunderstandings that might otherwise blossom into litigation based on correspondence or conversations during negotiations.
- b. Second, it unequivocally conveys the employee's understanding of and voluntary commitment to the agreement's terms. The employee's understanding is reinforced by a provision for consultation with the employee's legal counsel. High-level employees who are asked to sign employment agreements typically consult their lawyers before doing so. Therefore, the employer does not lose anything by including this provision:

Entire Agreement

(a) This Agreement embodies the entire agreement of the parties hereto with respect to its subject matter and merges with and supersedes all prior discussions, agreements, commitments, or understandings of every kind and nature relating thereto, whether oral or written, between Employee and the Company. Neither party shall be bound by any term or condition other than as is expressly set forth herein.

(b) Employee represents and agrees that he or she fully understands his or her right to discuss all aspects of this Agreement with his or her private attorney, that to the extent he or she desired Employee availed himself or herself of this right, that Employee has carefully read and fully understands all of the provisions of the Agreement, that Employee is competent to execute this Agreement, that his or her decision to execute this Agreement has not been obtained by any duress, that Employee freely and voluntarily enters into this Agreement, and that Employee has read this document in its entirety and fully understands the meaning, intent, and consequences of this Agreement.

C. Conclusion

1. Every employment contract is tailored to the specific terms offered by an employer. The foregoing clauses should be considered templates that should be modified to fit the actual agreement.
2. The employment contract will sometimes be modified through negotiation. For example, "cause" may be defined differently or bonuses spelled out in detail. But the suggested clauses should at least trigger further thought in drafting and negotiating high-level employment contracts.

To purchase the online version of this outline, including editable versions of the provisions it contains, go to www.ali-aba.org and click on "online"