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Drafting Effective Employment Agreements: Keeping the Employer's Best Interests in Mind

By Bennett Pine

This article is Part I of a two-part series of tips on how to draft effective employment agreements from an employer's perspective. Part II will appear in our next issue.

With more and more executives, managers and professionals in the modern work place demanding (and receiving) written agreements setting forth their terms and conditions of employment, employers should be aware of what they are "getting themselves into" when providing such written employment contracts. In Part I of our two-part series, we explore the concept of employment-at-will and the benefits of having an employment agreement, as well as the following key clauses: scope of employment, term, termination, base salary and bonuses. In Part II we will explore other key clauses, such as company stock, benefits and vacation, how to deal with confidential information, along with non-compete and other standard provisions.

It is essential that in preparing employment agreements management should take appropriate steps to retain sufficient entrepreneurial rights and operating flexibility. Management also must bear in mind the consequences of providing guaranteed terms of employment for an extended period of time, and should never lose track of the need to retain the right to terminate the employment relationship in a cost-efficient manner.

Why An Employment Agreement?: Employment-at-Will 101

In New York, and most other states, an employee who is hired without a written employment agreement for a definitive period of time is considered an "employee-at-will." That is, his/

A Note from the Editor

We are saddened to inform our readers of the death of our colleague David Dretzin, Esq., who many know, served as a contributor to this newsletter for many years. Mr. Dretzin was a highly regarded practitioner in the field of labor and employment law. We dedicate this issue to his memory, his many contributions to the field of labor and employment law and to this newsletter.

—Bennett Pine

Litigation Corner

Supreme Court Broadens the Definition of Retaliation Under Title VII

By Dona Kahn and Valerie Charles*

On June 22, 2006, the United States Supreme Court clarified and expanded the definition of retaliation under Title VII of the 1964 Civil Rights Act. In a unanimous decision, the Court held that Sheila White, a railway company maintenance worker, had a cognizable retaliation claim, even though she was neither terminated nor demoted. *Burlington Northern & Santa Fe Railway Co. v. White*, No. 05-259 (June 22, 2006). After complaining of gender discrimination in 1997, White was transferred to a different position at the railway company. Though the new position had the same salary and benefits, the evidence showed the new job was more difficult and less prestigious. After the transfer, White was briefly suspended without pay for insubordination, but she was reinstated and awarded back pay after Burlington determined that she had not been insubordinate. The Supreme Court ruled that both White's transfer and brief suspension were sufficient to support a Title VII retaliation claim.

The Court's decision sets forth a new test, settling years of inconsistency among federal appellate courts. According to the Supreme Court, any action that "materially harms" an employee and would dissuade a reasonable person from making or supporting complaints of discrimination is

"Supreme Court Broadens..." continued page 3

her employment may be terminated, at any time, for a good reason, a bad reason or no reason at all, except that the employment may not be terminated for a illegal reason. Typically, the most common illegal reasons arising from employment termination are discrimination in employment (e.g., age, race, sex, religion, national origin, disability, etc.), retaliation or whistle-blowing. Employees seek employment agreements in order to modify their at-will status, guarantee employment and compensation for a definitive period of time and to spell out the specific salary, bonuses, employee benefits and other perquisites of employment to which they are entitled. Employers may also utilize employment agreements in order to comprehensively and clearly recite the executive's duties, expectations, reporting relationships, compensation and benefits so as to avoid costly and time-consuming disputes later on as to "what the parties agreed to." In addition, employment agreements can provide a useful tool for employers by restricting the types of activities in which the employee may engage during and, more significantly, after the employment relationship ceases to exist.

Key Clauses: Scope of Employment; Reporting Relationships

The employee's job title, duties and responsibilities should be set forth as broadly as possible. Rather than a narrowly delineated set of duties, the employee should also be expected to perform "all such other duties, consistent with Employee's position as may be assigned to him from time to time." It is, therefore, essential that the employer retain the right to change the employee's duties, responsibilities and even job title in the best interest of the business, particularly where the employee is "not working out" or a performance issue has arisen. As long as the employee's compensation and benefit package remain intact, s/he may be hard-pressed to successfully establish any damages arising from a claimed demotion or constructive termination. The reporting relationship chain should also be set forth. Will the employee report to the chairman, president, chief executive officer, the board of directors or some other individual? It may be advisable to have the employee report to some *combination* of these positions, again to retain operating flexibility and managerial discretion.

Employers may also want to avoid limiting the place of employment to one particular location. An employer once told me that it avoids the need to terminate executives simply by transferring them to a far-away and/or undesirable location.

Term: Keep It Short

Employers are well-served to keep the employment relationship as close to employment-at-will status as possible. Generally speaking, long term agreements are to be avoided. Many employees are shocked and surprised to learn that the "two-year" agreement which they have just signed, and which contains a lengthy recitation of their salary, title, duties, medical benefits, company car, etc. also contains a clause providing that the agreement may be terminated "upon fourteen (14) days' written notice." In reality, what they have received is an employment contract with a term of two weeks, rather than two years!

Termination: Hidden Key To The Employment Agreement

We have pointed out to a number of our management clients that the most important clause in an employment agreement is the *termination* clause. Analogous to discussing the terms of divorce when entering into a marriage, this is an item that many employers pay little attention to when recruiting a "hot executive." Time spent thinking about an exit strategy at the very outset of an employment relationship, however, constitutes time (and attorney's fees) very well spent. Remarkably, a number of companies have sought our advice regarding "homemade" employment agreements which contain no termination clauses at all, but, rather, which go on in perpetuity. Often times, these agreements have been drafted by the executive's own counsel and presented to the employer for acceptance. Avoiding obligations under such "lifetime" contracts can be expensive for the employer. Generally speaking, an employment agreement should be terminable by the employer with or without cause. An employer should be absolutely free to terminate the employee for any reason whatsoever, i.e., "without cause." In such a case, however, it is typical to specify the compensation and benefits the employee is entitled to receive in such an event. The employer should seek to negotiate payment of a relatively modest sum, e.g., 30- or 60-days pay, in the event of a termination without cause. Employees, on the other hand, will seek to specify a much greater sum, ranging from the full balance of the agreement's duration to six or 12 months of compensation. It is worth noting

that whatever the agreement provides, the parties are likely to negotiate a settlement, in exchange for a release, which may provide severance pay and/or medical and other benefits greater than specified in the agreement. For that reason, employers are well advised to keep contractually mandated severance as low as possible.

The agreement should also provide that it can be terminated *without* payment of further compensation or benefits for "cause." Employers often misconstrue what constitutes cause. They must understand that cause is not typically present or established where the employee simply is "not working out," is "not a good fit" or "not what the company had in mind." Rather, cause typically connotes the showing of a material negative act or omission by the employee or a failure to perform. Something "bad" must generally be demonstrated by the employer. The typical definition of cause will set forth a litany of grounds including: conviction of a felony or act of moral turpitude; commission of an act of fraud, dishonesty, theft or disloyalty; failure or refusal to perform assigned duties or instructions; material breach of a provision of the agreement; or disclosure of the employer's confidential information. It is also common to provide for a short period of time (e.g., 10 days) in which the employee will be afforded the opportunity to "cure" the cause presented by the employer.

Base Salary and Bonuses

Base salary should not be a guaranteed annual sum. Instead, it should be set forth "at the rate of $___ per annum, payable in accordance with the Company's normal payroll practices." This guards against the employee being able to claim that the term of employment, and hence compensation, was guaranteed for a year or some other fixed period of time.

If the agreement is to be for more than one year, annual increases in base salary may be specified at the time the agreement is entered. If possible, in order to obtain maximum flexibility, the employer may simply want to include language to the effect that salary review "will be discussed with the employee no later than [date]," or "shall be made in accordance with the provisions set forth in the Company's manual." It is also common to include a section for bonus payments in the agreement. Depending upon the bargaining leverage of the parties, the employee will seek a fixed or minimum bonus payment, at least in the first year of employment. We believe it is preferable to tie the annual bonus to some objective basis for measuring performance, such as increases in sales and/or profit figures. Even better is a statement to the effect that the employee expressly acknowledges that both the *decision* whether to grant a bonus, and the *amount* of any such bonus, lies in the complete discretion of the employer.

Bennett Pine is a shareholder in the New York office of Anderson Kill & Olick, P.C. and co-chair of Anderson Kill's Employment and Labor Law Department. Mr. Pine's practice includes counselling and representing management in all aspects of labor and employment law. Mr. Pine can be reached at (212) 278-1288 or bpine@andersonkill.com.

Litigation Corner continued from p1

actionable as retaliation. The Court held that the employee harm need not be related to the terms and conditions of employment. The new standard will be an adjustment for those circuits that formerly predicated retaliation claims upon "ultimate employment decisions," such as formal demotion (which indicates lower pay) or termination.

While Justice Breyer's opinion seems to pave the way for more retaliation lawsuits, the Court was careful to note that "ordinary tribulations" at work are not actionable, including personality conflicts and teasing. The goal of the Court was to keep trivial conduct out of the judicial system, while deeming cognizable those claims of material harm that would discourage employees from complaining about discrimination. Despite efforts to strike such a balance, the consensus among employment lawyers is that the new standard is a broad, pro-employee move by the Court, likely to make retaliation claims easier to establish. It remains to be seen, however, whether litigation proceeding under the new standard will generate imbalanced results. In any event, employers are well advised to proceed carefully before taking any form of adverse action against an employee who has complained of discrimination.

Dona Kahn is co-chair of Anderson Kill's Employment and Labor Law Department and has extensive litigation experience in representing management in employment-related matters. Ms. Kahn lectures frequently on employment and discrimination law issues as well as trial practices. She can be reached at (212) 278-1812 or dkahn@andersonkill.com.

*Valerie Charles, a summer associate with the firm, contributed to this article.

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For more information, please visit our website at www.andersonkill.com or contact the Employment and Labor Law Department's co-chairs, Bennett Pine at bpine@andersonkill.com or (212) 278-1288 or Dona S. Kahn at dkahn@andersonkill.com or (212) 278-1812. The other members of the department include Mary Baerga, Melvin Salberg, Gail Eckstein, Melissa Rubenstein, John J. Hess, Michael J. Lane, Marisa J. Steel, Cathleen C. Tylis, Mark Weldon and Sloan Zarkin.

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Anderson Kill & Olick, P.C.
1251 Avenue of the Americas
New York, NY 10020