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REDUCING POST-TERMINATION DISPUTES: A NATIONAL SURVEY OF CONTRACT CLAUSES USED IN EMPLOYMENT CONTRACTS

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ABSTRACT

The increased popularity of employment contracts in recent years is due to several factors, including a tight labor market, frequent mergers and acquisitions, and greater concern by employers over trade secrets and other intellectual property. Many disputes involving employers and former employees could be eliminated and the potential for litigation greatly reduced if the issues that often give rise to complaints were addressed in an "up-front" employment contract. This article examines issues that may be addressed at the time of contracting. Part I describes the most popular and potent clauses used in employment contracts. Part II contains a report based on a national survey of human resource professionals. The findings from this study suggest that the different clauses are applicable only in certain cases—for certain employee types and certain companies. Other than issues of compensation and the protection of proprietary information, there is little agreement on the use of the thirty-two clauses identified for this study. Employers use a variety of provisions to tailor the employment contract to their particular needs.

Once used by employers almost exclusively for sales, technical, and research professionals, employment contracts are being used increasingly for all types of managers and professionals. The increased popularity of employment contracts in recent years is due to several factors, including a tight labor

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market, frequent mergers and acquisitions, and greater concern by employers over trade secrets and other intellectual property. As the “knowledge industry” and the number of knowledge firms expand, this latter emphasis will become even more critical.

With unemployment in the last decade at historically low levels, individuals seeking employment have realized they don’t have to “take it or leave it.” Highly sought-after applicants are negotiating for more attractive terms of employment, and employers are more willing to negotiate to attract and retain quality employees, particularly for positions where qualified employees are in short supply. Also, these same employees are defecting and often taking the employer’s trade secrets with them.

Downsizing, mergers and buyouts have become more common in recent years. This has caused employees to consider their possible fate if their job is eliminated. Concerns about job security are often addressed in a contract.

In today’s technology-oriented environment, both employers and employees have a heightened interest in rights to intellectual property—patents, copyrights, trademarks, and trade secrets. Contracts can clarify issues concerning who owns the intellectual property and who has rights to use it.

Many disputes involving employers and former employees could be eliminated and the potential for litigation greatly reduced if the issues that often give rise to complaints were addressed in an “up-front” employment contract. Consider, for example, the following issues.

To what extent may an employee who terminates be prohibited from working for a competitor?

What restrictions may employers use to protect trade secrets or other proprietary information?

Who gets to keep the technical training manuals?

What about other property that has been provided to the employee?

This article reviews important issues that may be addressed by the parties at the time of contracting. Part I describes the most popular and potent clauses used in employment contracts. It is not intended to be an all-inclusive listing of possible clauses governing employment issues. Elaboration and analysis of the law pertaining to each provision is beyond the scope of this article, and nothing in this article is intended to be legal advice. Employers and employees should seek the advice of a knowledgeable attorney before deciding upon the content and language of an employment contract.

Part II contains a report based on a national survey of human resource professionals. Respondents were given a list of the clauses described in Part I and asked to indicate the extent of usage of each. Basic demographics describing the respondents and their responses are provided in the section.

PART I: CLAUSES

Before addressing the specific items that should be considered for inclusion in an employment contract, some general observations are worth noting. The law governing the elements required for a valid enforceable contract and the law determining the enforceability of the specific provisions included in the contract are generally matters of state law. These laws may vary substantially from one state to another. It is quite possible that a contract provision that is enforceable in one state may be unenforceable under the law of another state.

Reasons for Termination

In an individual employment contract, there is often a clause specifying reasons for termination. This protects an employee from termination for other reasons. It is likely an employer would prefer language that protects the policy of employment-at-will that exists in many states. Contract language stating that employment is not for any definite period and may be terminated at any time for any reason may be appropriate.

The doctrine of employment-at-will states that unless there is a contract stating otherwise, employers have the legal right to terminate an employee for any reason—good cause, no cause, or bad cause—as long as termination for that reason does not violate some state or federal law. This doctrine is generally recognized in all states, subject to a number of exceptions that have been carved out by court decisions. The exceptions to employment-at-will generally are based on one of the following theories:

1. Implied employment contract (often based on statements made in employee handbooks, employment application forms, etc.).
2. The tort theory that a termination violates established public policy.
3. The theory of an implied covenant of good faith and fair dealing existing between the employer and at will employees, and
4. The tort theory of abusive discharge.

The laws of most states recognize one or more of the above listed exceptions thereby providing employees with some degree of protection against a wrongful discharge. In fewer than ten states, however, employment at will is adhered to strictly by the courts (i.e., none of the above exceptions are recognized). In some of these states (e.g., Louisiana), the courts have stated that if there are to be any exceptions to the employment-at-will doctrine, they must be created by legislative action.

If any employee desires to alter the at-will relationship, s/he may do so by contract. A relatively small number of managerial and professional employees have been successful in negotiating employment contracts in which the employer and the employee agree that the employer cannot terminate the individual

unless there is good cause. The parties may specify that termination may occur only upon the occurrence of certain specified events. It is generally recognized that approximately three-fourths of the nation's workforce is employed "at will" and does not have "good cause" or "just cause" protection against terminations negotiated by unions, granted by governmental entities, or negotiated by individuals.

Anti-Competition

One of the most-often used provisions in employment contracts is a clause that prohibits the employee from working for a competitor after leaving the current employer. Such anti-competition agreements have long been used in employment contracts of executives, sales representatives, and research/technical personnel. As employers have become more competitive and more concerned about proprietary information getting into the hands of their competitors, noncompete covenants are being included more often in contracts involving managers and other professionals.

These clauses are generally enforceable to protect a legitimate business interest of the employer. If the scope of the prohibition is reasonable in duration and geographic area, the covenant generally is enforceable under the laws of most states.

Trade Secrets/Proprietary Information

Management may have good reason to include an anti-competition clause and an agreement that if the employee does go to work for a competitor, s/he is prohibited from using the employer's trade secrets. Properly constructed employment contracts could help reduce the growing trend of high-profile, trade-secret disputes involving executive defections. In today's environment of increased competition, there is more pirating of key employees by competitors and more litigation over what knowledge those employees take with them [1].

To ensure a meeting of the minds on what is considered proprietary information, a definition should be clearly spelled out. The definition should include such things as designs, processes, procedures, technical reports, marketing plans, and client lists.

This agreement generally includes a statement that the employee agrees not to publish or to make any unauthorized use, or public disclosures of any intellectual property, confidential information, or trade secrets during or subsequent to employment by the company.

Intellectual Property Rights

Many employers state that any patents or copyrights obtained by the employee during his employment with the company or based on information gained during

his employment, become the property of the employer. It is reasonable for an employer to retain the intellectual property rights for materials that are the result of the employee's efforts on the employer's behalf. Often, the employer's resources made the development of the information or product possible. Employees should be careful not to give up ownership of patents or copyrights already obtained prior to joining the employer.

Indemnification

A clause providing indemnification would provide compensation to executives for legal expenses associated with the performance of job duties. It is in the employee's best interest for the clause to state that the company will provide indemnification for a specified time beyond the date the executive terminates employment. The indemnification, however, should not apply to acts that are intentional, grossly negligent, or undertaken outside the scope of employment.

Mandatory Arbitration

Since *Gilmer v. Interstate/Johnson Lane Corp* was decided by the U.S. Supreme Court in 199l [2], employment attorneys have generally encouraged employers to include compulsory arbitration clauses covering all potential employment-related claims in their employment contracts.

The U.S. Supreme Court recently made it easier for more employers to require employees to resolve job disputes through arbitration rather than lawsuits. In *Circuit City Stores v. Adams,* the Court held that the Federal Arbitration Act of 1925, which requires the enforcement of valid arbitration agreements, applies to most employment contracts and exempts only contracts involving transportation workers [3].

While resolving a major issue, the Court's ruling did not address other issues concerning the enforceability of arbitration agreements. Questions such as who pays for the proceedings and what constitutes valid consideration (i.e., what, if anything, must the employer give the employee in exchange for the employee's agreement to arbitrate instead of sue) are left for employers, employees, and courts to resolve.

For a variety of reasons, many employers include a clause in the contract requiring arbitration for certain types of disputes. Generally, arbitration is much cheaper and quicker than litigation. Arbitration also provides the parties with a confidential means of resolving the dispute and avoids the public spotlight associated with litigation.

Acknowledgment of Policy

In the recent cases of *Faragher v. City of Boca Raton* and *Ellerth v. Burlington Industries,* the U.S. Supreme Court articulated a new standard for vicarious

(employer) liability for sexual harassment by a supervisor [4, 5]. An employer has an affirmative defense where the employer has a sexual harassment policy in place that is published and adhered to. To satisfy the requirements for the affirmative defense, the employer may want to have the employee acknowledge, in the employment contract, that s/he has received a copy of the company's sexual harassment policy and agrees to adhere to such policy.

Foreign Assignments

Employment contracts are particularly useful when the employee may be assigned to projects outside the United States. These assignments can involve many special considerations. Compensation should be described in terms of United States dollars. If inflationary pressures in the foreign country might erode the employee's earning capacity, a clause addressing cost-of-living adjustments may be appropriate. Other items for consideration include a minimum number of trips home at company expense, and tuition assistance or other educational provisions for members of the employee's family. An employee would be well-advised to include a provision for travel and moving expenses back to the United States upon termination of the contract, regardless of the reason for the termination.

Basic Terms and Conditions

From the employer's and the employee's perspective, among the most important topics that should be clearly delineated in the contract are terms and conditions. Items that should be addressed include not only the more traditional items but also a variety of provisions that can be tailored to address practically any concerns of either party. Items for consideration include:

- Position and responsibilities.
- Beginning and ending dates of employment.
- Salary.
- Benefits to which employee is entitled under various circumstances.
- Conditions that must be met for contract renewal, salary increases, promotion, various benefits, etc.
- Compensation due employee if contract is terminated prematurely by employer.
- Description of employee's responsibilities particularly if unusual.
- Deadlines or specific results to be achieved, e.g., dates for satisfactory completion of stages of project.
- Performance expectations.
- Incentive clauses.
- Severance package.

Other Often-Used Provisions

Choice of Law or Forum

For a number of reasons, an employer may desire that the law of a particular state (e.g., where the business is incorporated) govern all questions on the validity of the contract. The employer may also want to choose the forum (the court) where such questions are determined.

Ownership of Company-Supplied Materials and Equipment

Employers will usually specify those items that will be deemed company property and state when and under what conditions items must be returned to the employer.

Sole Agreement

Employers may add a statement that this agreement is the sole agreement which supersedes any agreement or understanding previously existing between the employee and the company.

Alteration of Contract

The employer may include a statement that any changes in the original contract must be in writing and signed by a member of management and the employee.

"Outside Employment"

The agreement should provide that the employee is restricted from engaging in any other employment while employed by the company. However, this restriction generally does not apply to investment opportunities not in competition with the employer.

Solicitation of Employees

The employer may include a clause whereby the employee agrees not to induce or influence any employee of the company to terminate his/her employment with the company.

Employer Rights

Where appropriate, the employer may want a statement that clarifies its rights to reassign the employee to another project or location. Similarly, the employee may want a statement that s/he will not be required to perform tasks inconsistent with his/her stature within the company.

Severability

As a safety precaution, the employer should include a statement that if any provision in the employment contract is found by a court to be unenforceable, the remaining clauses shall be valid and enforceable.

Remedies

Employers should consider a provision that where there is a violation or an attempted violation of any agreement pertaining to non-competition, disclosure of trade secrets, confidential information, etc., the employer has the right to an injunction in addition to any other remedies available by law. State courts will generally allow injunctive relief without the necessity of proving damages where such a contractual provision exists.

In addition to the many issues addressed thus far, the list of subjects and provisions that may be included in a contract is endless. Terms may be as varied as the concerns and needs of the parties. Additionally, employers should avoid using any ambiguous language in the contract to help reduce the potential for misunderstanding that can invite needless litigation. As a general rule, if a legal controversy arises involving the meaning of an ambiguous term, courts will usually construe that term against the party who chose that language when constructing the contract, usually the employer.

PART II: NATIONAL SURVEY

To determine the current practices of firms in the United States regarding the extent of usage of the various clauses discussed above, a survey was conducted using a mail questionnaire. During November, 2000, questionnaires were distributed nationally to practicing human resources professionals. A proportional sample was designed to provide a representative response based on geography, size of firm, and industry. One hundred and twenty-three usable surveys (12.3 percent) were returned. A basic description of the respondents and their responses follows.

Survey Results

Industry Classification

The responding firms were classified according to the basic industries to which they belonged. Table 1 shows that almost half of the respondents' firms are in the manufacturing sector. Around 30 percent are in various services. Less prominent in the survey, but somewhat representative were energy, retail trade, and wholesale/transportation/warehousing.

Table 1. Industry Classification

	Frequency	Percentage
Manufacturing	54	44
Services	36	29
Energy and utilities	11	9
Retail trade	11	9
Wholesale/transportation/warehousing	9	7
Missing	2	2
Total	123	100

Sample Firm Size

The size of the respondents' firms was measured by the number of employees. Respondents were asked to indicate the size of their firms' workforce using one of six categories. As shown in Table 2, the sample was representative of the various categories. However, the "5000 or more" category was relatively large, indicating that the responses to the items on clauses may be skewed in that direction.

Geographic Representation of Sample

Companies from thirty-five states responded to the survey. The 120 firms that responded to this item were placed into one of four categories: Southeast, Northeast, Midwest, and West. The numbers contained in Table 3 reveal a rather proportionate geographic distribution of the respondents. The West was slightly less well-represented. However, that may be due to the fact that the majority of the states without representation in the survey results are from that part of the country and have relatively low populations.

Before moving to the survey responses regarding contract practices, it should be noted that there is a likely bias toward relatively large manufacturing and service firms.

Extent of Use of Contracts

The first contract-related question of the survey was designed to determine the extent to which respondents' firms rely on employment contracts. Only 6 percent of the respondents indicated that they *always* use contracts for

Table 2. Number of Employees

	Frequency	Percentage
1-99	3	2
100-499	26	21
500-999	19	16
1000-2999	22	18
3000-4999	16	13
5000 or more	36	29
Missing	1	1
Total	123	100

Table 3. Geographic Representation

	Frequency	Percentage
Southeast	32	26
Midwest	32	26
Northeast	33	27
West	23	19
Missing	3	2
Total	123	100

employment. At the other end of the absolute spectrum, a surprising 31 percent stated that they *never* use employment contracts. The majority of the respondents (63 percent) selected the two non-absolute categories, suggesting that individual circumstances dictate the use of contracts (see Table 4).

Respondents who indicated that they will never use employment contracts were asked to explain the reasons for their response. Of the thirty-eight respondents who indicated that their firms will likely never use an employee contract, twenty-seven offered explanations, and the following representative responses were provided.

"Prefer dealing with employees at will."
"[State] is a right-to-work state."

Table 4. Extent of Usage of Contracts

	Frequency	Percentage
Never	38	31
Occasionally	67	54
Often	11	9
Always	7	6
Total	123	100

"No use for employee contracts."
"We adequately staff with qualified recruiters."
"If used, it would be for contractors or project personnel only."
"Good employees are becoming harder to find."
"New future issues may warrant them, but not at present."
"We are a subsidiary and contracts are not used at the plant level."

These comments range from interesting to absolutely incredible. Two in particular are on the extreme end of the continuum. Given the many clauses that may be designed to protect the employer's interests, it is amazing that any employer could find "no use for employee contracts." Similarly, it is incredible that professionals responsible for human resources could state that employment contracts will never be used in their organizations because "[state] is a right-to-work state." Right-to-work laws allow a person the right to work without having to join a union and have virtually no impact on the issue of whether or not an employer may use employment contracts.

Employee Types

Another revealing question addressed the types of employees for which contracts are used by the respondents' firms. Approximately one-third (33 percent) of the respondents chose not to respond to this item (see Table 5). Slightly more than half of the respondents indicated that their firms use contracts for top executives. Just over 10 percent of the respondents indicated the use of contracts for middle management personnel, while just under 10 percent use contracts for lower management. Perhaps the most surprising response to this item are the relatively low number of firms that use employment contracts for research and development (under 10 percent) and for technical

Table 5. Positions for Which Employment Contracts are Used

	Yes	No	No response
Top Executives	68	15	40
Middle Management	17	66	40
Supervisors and Lower Management	11	72	40
Research and Development	11	72	40
Sales and Marketing	23	60	40
Technical	15	68	40

employees (12 percent). Not so surprising is the 20 percent response for sales and marketing.

Contract Clause Usage

The last item addressed the usage of specific clauses for employment contracts. Respondents were presented a list of thirty-two conventional clauses and asked to indicate which ones were used by their firms. The clauses and responses are shown in Table 6. Only six items were selected by more than 50 percent of the respondents (Bonus Program, Non-competition, Other Compensation, Salary, Termination of Contract, Title). However, it is interesting to note that half of these items relate to some form of compensation.

Seven clauses appear to be less popular since they were selected by fewer than 20 percent of the respondents:

Accommodation for Disabilities
Training and Development
Leave
Overseas Assignments
Indemnification
Acknowledgment of Sexual Harassment Policy
Consensual Relationships Between Employees

It is interesting to note that four of the seven issues—disabilities, leave, sexual harassment, and consensual relationships—are addressed by federal and state statutes. Of these issues, clauses that deal with acknowledging an employer's sexual harassment policy and clauses that attest to the consensual nature of

Table 6. Usage of Contract Clauses[a]

	Frequency	Percentage
Accommodation for Disabilities	12	10
Acknowledge Sexual Harassment Policy	10	08
Alteration of Contract	28	23
Bonus Program	66	54
Change of Ownership or Control	39	32
Choice of Law	30	24
Conditions of Renewal	31	25
Consensual Relationships Between Employees	1	01
Consequences of Termination	38	31
Entire Agreement	49	40
Indemnification	18	15
Intellectual Property Rights	39	32
Leave	8	07
Mandatory Arbitration	23	19
Noncompetition	67	55
Other Compensation	67	55
Overseas Assignments	8	07
Ownership of Company-Supplied Resources	24	20
Payment Upon Separation	57	46
Primary Location	37	30
Remedies	25	20
Required Notice of Termination	42	34
Salary	73	60
Scope/Description of Responsibilities	48	39
Severability	39	32
Solicitation of Employees	31	25
Termination of Contract	67	55
Terms of Employment	52	42
Title	73	60
Trade Secrets/Proprietary Information	60	49
Training and Development	6	05
Waiver of Rights	16	13

[a]Respondents were asked to note all uses of contract clauses.

an employee relationship will likely grow in popularity among employers. As addressed previously in this article, the U.S. Supreme Court has provided employers with ample motivation to engage in affirmative efforts to reduce liability for sexual harassment.

CONCLUSIONS

A significant number of clauses are commonly used for employment contracts. However, only a relative handful seem to be used consistently for a variety of contracts. It is particularly noteworthy that approximately half of the survey respondents are using provisions to protect trade secrets/proprietary information and provisions to prevent former employees from working for competitors.

The findings from this study suggest that the different clauses are applicable only in certain cases—for certain employee types and certain companies. Other than issues of compensation and the protection of proprietary information, there is little agreement on the use of the thirty-two clauses identified for this study. Employers wisely use a variety of provisions to tailor the employment contract to their particular needs.

Employers should consider increasing their use of employment contracts, particularly for mid-level to upper-level managers. Edward Lawler, in the concluding section of his longitudinal study of Fortune 1000 companies stated: "Our results also show that a number of factors influence the effectiveness of . . . management programs. One of these, which we studied for the first time in 1996, is the nature of the employee contract; having the correct employment contract can contribute substantially to success" [6].

Employer concerns about unfair competition, intellectual property rights, trade secrets, and other proprietary information, combined with the increased use of mandatory arbitration, give employers ample reason to protect their interests with employment contracts. In addition to concerns over these same issues, employees should focus attention on clauses addressing reasons for termination by the employer, separation issues, and other terms and conditions like compensation, benefits, beginning and ending dates of employment, and contract renewal. Many disputes involving employers and employees can be eliminated and the potential for expensive litigation greatly reduced if the issues that often give rise to complaints are addressed in a well-drafted employment contract.

ENDNOTES

1. W. M. Carley (1998). Secrets Suit: What Did He Know? *Wall Street Journal,* January 20, p. B1.
2. *Gilmer v. Interstate Johnson Lane Corp.,* 111 S. Ct. 1647 (1991).

3. *Circuit City v. Adams,* 121 S. Ct. 1302 (2001).
4. *Farragher v. City of Boca Raton,* 118 S. Ct. 2275 (1998).
5. *Ellerth v. Burlington Industries,* 118 S. Ct. 2257 (1998).
6. Edward E. Lawler, III, S. A. Mohrman, & G. Benson (2001). *Organizing for Higher Performance,* Jossey-Bass, p. 212.

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