

## **PREEMPLOYMENT AGREEMENTS: A BOON FOR EMPLOYERS OR A BOONDOGGLE FOR EMPLOYEES**

by

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In recent years there has been a proliferation of preemployment agreements in which job applicants are required to sign contracts promising to engage in or refrain from certain behaviors in order to be considered for employment. Once reserved for the highest-ranking executives, these agreements increasingly are being required of other applicants and employees, from decision makers through middle managers to rank-and-file employees, especially those in high-tech occupations.<sup>1</sup> A possible reason for this trend is the economic shift from manufacturing to service.<sup>2</sup> Another factor contributing to the increased usage of preemployment agreements is that more organizations realize that their most valuable resource is trained and skilled employees and the information they possess.<sup>3</sup> As a means of protecting that information more firms are turning to employment agreements for self-protection.

General considerations of preemployment agreements and their place within the context of contract law will begin the discussion. Also presented are five frequently recognized preemployment concepts: training expense reimbursement, non-disclosure of business information and trade secrets, non-competition by the employee, mandatory dispute resolution, and non-solicitation. Next, the implications of preemployment agreements for both employers and employees are explored. The paper concludes by identifying additional areas where preemployment agreements may be warranted.

### **I. Preemployment Agreements—General Legal Considerations**

Employment agreements between employers and employees explain various aspects of employment relationships.<sup>4</sup> Agreements vary from industry to industry, employer to employer, and from applicant to applicant. Agreements may regulate a single aspect of employment (e.g., when the employee is entitled to pay increases or under what circumstances the employee may be terminated) or may cover the entire employment relationship.<sup>5</sup> Agreements may be presented in the form of formal written contracts, or in an employee handbook, or through other means. Some employers have incorporated such agreements into employment applications.<sup>6</sup> Simply signing the application form may constitute a preemployment contract. Though more common to some industries than to others (e.g., high tech), the use of such agreements may be found in other sectors of business and industry, including security, retail, restaurants and hotels, health care, and broadcasting.<sup>7</sup> Irrespective of the business classification, the legal force behind all preemployment agreements falls within the legal theory of contracts.

#### **A. Preemployment agreements are contracts.**

Preemployment agreements are contracts and are therefore governed by basic common law contract principles. Even though each state has enacted legislation which affects various and specific employment contract principles, basic common law contract theory still remains intact. All states basically recognize that contracts require (generally) an offer, an acceptance, and consideration.<sup>8</sup> With preemployment contracts the employer is offering the applicant a job or considering offering a job (the offer) and the applicant is agreeing to take the position (the acceptance). Signing of the preemployment contract is the formal acceptance which consummates the agreement between parties. The other essential element is consideration, which is the requirement that some benefit be exchanged between the contracting parties. The element of contractual consideration is established by the applicant being considered for employment and the employer being able to evaluate the applicant for employment. The signing of the document is merely the acknowledgement of the mutual benefit.

In most contracts, there is some degree of negotiation between the signing parties as to terms, conditions, and performance. In preemployment agreements, there is generally little or no negotiation. Employers write the contracts and applicants sign the contracts, or not. Employers typically reject changes that are proposed by applicants, unless the applicants or their skills are in great demand. In fact, if the applicants request too many changes, employers may not hire such potential “trouble-makers.” In the

absence of an essential skill or acute economic necessity, employees are placed in a “take it or leave it” situation.

Since preemployment contracts are no different than any other type of contract, certain duties and obligations are placed upon the parties to the agreement. One of the most important is the “duty to read.” Generally, applicants for employment pay little attention to what they are agreeing to in preemployment contracts. Paul Tobias, chairman of the National Employee Rights Institute, noted, “Future employees at the moment of hire don’t negotiate, don’t hire a lawyer, don’t tamper with those clauses, don’t even read them. They’re interested only in the money. They’ll sign anything.”<sup>9</sup> The signing of the preemployment agreement is considered no different than signing forms authorizing the withholding of taxes and social security from wages and salary or any other agreements for future benefits, such as life insurance and health benefits. In addition, employees who choose not to sign preemployment agreements likely will not be considered or hired. Applicants’ needs for employment are usually immediate, and any possible negative consequences of a signed contract are unimagined or considered distant or inconsequential. Legal advisors are obviously the ones to help applicants understand the importance of careful consideration of preemployment agreements.

A party to a contract is bound by the terms, conditions and covenants contained in the written or printed form, irrespective of whether the party read the document. “It is a cardinal rule of contract law, recognized by the Supreme Court more than a century ago, that a party is bound by a contract to which he signified his assent and cannot be heard to complain that he did not read its contents.”<sup>10</sup>

## **B. Preemployment agreement problems**

Even though preemployment agreements are recognized by the Courts and supported by extensive legal theory, certain difficulties can arise that could result in a provision or the entire agreement being declared unenforceable or void. The main areas being litigated are 1) contracts of adhesion, 2) overly broad restrictive covenants and/or, 3) agreements or clauses that violate public policy.

1) Adhesion contracts. Contracts that are entered into without “arm’s length” negotiations or where one party has all the bargaining authority are referred to as adhesion contracts.<sup>11</sup> Adhesion contracts are used and accepted as commonplace in business and other economic sectors. In today’s business society preprinted contract forms are used and available at any office supply store, in libraries, and on the web and cover a multitude of business topics. Employment contracts are no different. Many are preprinted and contained in the employment application, or the terms of the employment agreement appear in an employees’ handbook. Modification of a preprinted form is improbable if not impossible.

2) Overly broad provisions. Another means of contesting preemployment agreements is determining whether the contract is excessively broad and infringes upon employees’ ability to earn an income. The Court in *Labor Ready, Inc. v. Williams Staffing, LLC* provided additional guidelines which should be considered when enforcing employment restrictions, as follows: are the restrictions necessary for the protection of the employer’s business and goodwill; do the restrictions impose any greater restraint on the former employees than is reasonably necessary to protect the employer; is the degree of injury to the public such that loss of the service and skill of the former employee warrants non-enforcement of the covenant (contract). On a case by case basis, the Court must evaluate whether the contract language is limited or overly broad. The more limited the restrictions, the more likely is the enforcement by the Courts; and conversely, restrictions which are overly broad and do not protect some of the employer’s interests will likely not be enforced by the Courts.<sup>12</sup>

3) Public policy violations. A third mechanism for disputing preemployment agreements (or provisions within) is based on violation of statutes or public policy. At both the federal and state levels there are numerous employment-related laws and regulations which place restrictions on the employer/employee relationship. In the context of preemployment agreements, the employer will be prohibited by these statutes from implementing certain contract restrictions (e.g., California does not permit non-compete agreements).

Courts will enforce contract clauses that protect the proprietary rights of employers against employees. Traditionally the employer, alleging misuse of a trade secret, will seek an order enjoining the former employee and/or successor employer from using the trade secrets. The owner of the trade secrets can also seek monetary damages, but many times the monetary damages cannot compensate the employer’s business for the irreparable, long-term harm to the business. Courts have generally been very protective of trade secrets. For example, the Georgia Trade Secrets Act of 1990 protected trade secrets in written

agreements even where there was no stated duration of the agreement or geographical limitation on the restrictions.<sup>13</sup>

Courts are sometimes required to determine public policy in the absence of statutes. As such, there appears to be an inconsistent interpretation of public policy among states. Such is the case when dealing with the restrictive covenant “not to compete” (enforceable by way of an injunction), which is dependent upon whether the covenant is reasonable in time and geographic area.<sup>14</sup> In the case *Reed, Roberts Associates v. Strauman*, it is clear that the Courts must weigh the need to protect the employer’s legitimate business interests against the employee’s possible loss of livelihood.<sup>15</sup> Courts require a showing that a legitimate business interest is being protected by the covenant not to compete, that the business interest will suffer irreparable harm if the covenant is not enforced, and that the covenant is reasonable as to time limits for enforcement and reasonable in location where the not to compete clause is to be enforced.

## **II. Categories of Preemployment Agreements.**

There are five key provisions that most frequently appear in preemployment agreements and employment contracts. These provisions address the concepts of training expense reimbursement, non-disclosure of business information and trade secrets, non-competition by the employee, mandatory dispute resolution, and non-solicitation. These categories are based on available research addressing preemployment agreements. The use of these provisions depends on the nature of the business and the interests that the employer wishes to protect, and for that reason not every employment application or contract contains all of these provisions.

### **A. Training expense reimbursement**

Knowledge of specific business operation(s) and/or a specialty or highly technical knowledge which is only known by an employee of that business makes that employee very attractive to competitors. The hiring of a person with business and technical knowledge saves the new employer the time and expense of training, and the new employer may receive the ancillary benefit of the new hire bringing some unique knowledge from the preceding employer. Many employers therefore use trade-secret protection measures, which are designed very much like non-compete agreements, to protect their business.<sup>16</sup>

Many preemployment agreements provide for recoupment, in whole or in part, of training expenses from an employee, if the employee does not remain with the organization for a designated time period after completion of the training. These requirements are most typically enforced if the employee is developing a new or updated skill. At one time employers could invest in employees’ futures—by funding their training and education—with confidence that they were also investing in their companies’ futures. But as the workforce has become increasingly mobile, growing numbers of employers find that training and development activities may represent investments in employees’ marketability.<sup>17</sup> This is particularly telling when one considers the trend of employees working shorter periods for an employer. The Department of Labor reported that as of January, 2002 the median number of years employees work for their present employers is 3.7 years.<sup>18</sup>

In some instances, employers try to protect training investments by requiring that applicants and/or employees sign personal loan agreements or promissory notes (payable to the employer) which provide that the employees will repay the loan (cost of the training) if they do not work for the employer for a specific period of time. The notes or loans contain specific contract language that cancels the indebtedness if they do work for a specific period of time. Conversely, if the employee fails to meet the requisite time requirement the notes become immediately due and payable.<sup>19</sup>

Recoupment of training expenses is generally addressed in a preemployment contract in the form of a damage formula or liquidated damage provision. Several recent legal cases show how some Courts have treated the issue of recouping training costs. In the recently decided case of *Heder v. City of Two Rivers*, the plaintiff was a firefighter for the City of Two Rivers, Wisconsin, who was paid overtime wages while receiving paramedic training required by the City.<sup>20</sup> Under the collective bargaining agreement between the City and Heder’s union, the City paid the employee a “paramedic premium” equal to three percent of his base salary once he had completed his training. The terms of this agreement referred to these payments as a “stipend” rather than an increase in the employee’s base salary. The agreement further required the employee to repay an amount equal to the cost of tuition and books if leaving the job within the first three years after completing the paramedic training. The agreement also contained a “liquidated

damages” clause which provided for the repayment of the amount equal to all overtime received because of paramedic training and all stipends received for having completed the training.

Prior to three years after he completed paramedic training, Heder resigned and went to work as a firefighter for another city. Claiming that the agreement between the City and Heder's union entitled it to recover the costs associated with Heder's paramedic education, the City withheld all wages (including unpaid vacation) owed Heder during his final three weeks of work. Heder sued, claiming that federal wage and hour laws barred the City from recouping already paid overtime and already paid “stipend” payments.

The Court did not reject the concept of recoupment of the training expenses from Heder, but the Court did conclude that there were three basic flaws with the City's training repayment agreement. First, the Court flatly rejected the section of the training agreement stating that paramedic premiums or “stipends” were not part of Heder’s base salary. The Court pointed out that under the Fair Labor Standards Act (FLSA), any non-discretionary payments made to an employee—regardless of how they are labeled—are part of the employee’s wages, and not subject to any right of offset.<sup>21</sup> Second, the Court concluded that the City clearly violated the FLSA’s minimum wage requirements by withholding all of Heder’s salary for his last three weeks of work. Third, the Court was concerned about the absence of any proportionate reduction in the amount Heder owed. The Court spent most of the decision addressing the issues of what are “wages” and the “right of offset” by an employer against an employee under the FLSA provisions.

The *Heder* decision makes it clear that a preemployment agreement which provides for reimbursement of training expenses is enforceable. If the agreement is breached by the employee, the employer must seek collection separate and apart from any obligation still owed under the employment agreement. Again, the most important message *Heder* offers is that training reimbursement agreements are legal, and under most conditions, are here to stay.

More recently, Florida, Louisiana, and Colorado have enacted statutes in an attempt to protect employers’ investments in employee training expenses;<sup>22</sup> this concept may expand to other states, particularly in difficult economic times.<sup>23</sup> It appears that the main thrust of these statutes is to make enforceable “restrictive covenants” to reimburse training expenses, if they are contained in employment contracts. Conversely, Connecticut<sup>24</sup> and Michigan<sup>25</sup> have banned repayment agreements for employee training. Other states have not had to resort to legislative enactments to address recoupment of training expenses, and have accepted the concept as merely a contractual term and condition. In the case *Labor Ready, Inc. v. Williams Staffing, LLC*, the employer was a manual labor staffing agency. Former employees signed employment contracts with various restrictive covenants which included the restriction not to share how the employees and staff were being trained.<sup>26</sup> The staffing employees eventually left *Labor Ready* to work for a competitor. The Court found that under Washington law restrictive contractual covenants may be used to protect an employer’s investment in employee training.

## **B. Non-disclosure of business information and trade secrets**

A second preemployment provision addresses non-disclosure covenants or agreements. “The non-disclosure agreement is the 21<sup>st</sup> century equivalent of the medieval wax seal” says Kent Walker, associate general counsel of Netscape.<sup>27</sup> This agreement prohibits former employees from disclosing any proprietary business information to new employers. The Uniform Trade Secrets Act (UTSA), written by the National Conference of Commissioners on Uniform State Laws in 1985, was a draft for trade secrets legislation which could be adopted by state legislators.<sup>28</sup> To date, 42 states have adopted the act with varying degrees of modification. The UTSA prohibits the disclosure of certain trade secrets. The UTSA provides:

Trade secret means information, including a formula, pattern, compilation, program, device, method, technique, or process, that: (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by other persons who can obtain economic value from its disclosure to use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.<sup>29</sup>

Trade secrets are generally not known by the firm’s competitors and cannot be readily discovered by them through legitimate means. The company has a reasonable expectation to protect their secrecy. Employers have a right to protect trade secrets and proprietary information; however, asking former employees to refrain from disclosing information does not prevent employees from finding work, nor does it limit

employees' statutory rights or protections. Where trade secrets are involved in a business's operations, whether technical or managerial, they often represent the competitive edge required to compete with other similar businesses.

There are three requirements to have a misappropriation of a trade secret: 1) there is, in fact, a trade secret, 2) a third party acquires the secret as a result of a confidential relationship, and 3) the unauthorized use or disclosure of the said secret.<sup>30</sup> One example of a trade secret could include customer lists that are essential to the well-being of that business. Customer lists may be developed over long periods of time, including times while particular employees are working at a business. The lists are considered owned by the company and cannot be taken or used by the departing employee. These lists are also considered confidential and as such give the company a proprietary interest in protecting the list from disclosure. Companies have successfully gone to Court to stop past employees from using proprietary customer lists.<sup>31,32</sup>

Confidential information does not include "general knowledge, skill, or facility acquired through training or experience while working for an employer...."<sup>33</sup> In *Town & Country House & Home Services, Inc. v. Kenneth Evans*, the Court stated:

A list of customers, if their trade and patronage have been secured by years of business effort and advertising and the expenditure of time and money, constitutes an important part of a business and is the nature of a trade secret. It is the property of the employer and may not be used by the employee as his own property or to his employer's prejudice....<sup>34</sup>

Because the purpose of trade secret laws is to encourage innovation and development of business, the protection of the trade secret should not extend beyond the limits needed to protect genuine trade secrets.<sup>35</sup> A non-disclosure provision will provide only limited protection from former employees' disclosures of general business information obtained from employment. The Courts are only going to enter orders which ensure that the "trade secret" is not disclosed, and nothing more.

### C. Non-competition by the employee

A third preemployment situation deals with competition. A growing number of employers exercise control beyond the office or other work setting by requiring that employees sign non-compete agreements promising that they will not work for direct competitors or start competing businesses. In an atmosphere of increasing employee mobility, the use of such contracts by many businesses is on the rise—as is litigation over them.<sup>36</sup> It is not clear how many workers have signed employment contracts limiting their ability to change jobs, but the number is large and rising according to attorneys and employers. These agreements have become commonplace among technology workers, stockbrokers, and salespersons.<sup>37</sup> For many start-up and technology-based firms, the secrets these agreements are designed to protect are among these businesses' most valuable assets.<sup>38</sup> However, non-compete provisions in contracts appear to be surfacing in previously unexpected job situations. Starbucks prints warnings on its employment applications that employees who are trained as "Frappuccino makers" may have to sign non-compete agreements.<sup>39</sup> Additionally, security firms are demanding that non-competition agreements be executed by security guards.<sup>40</sup>

Service related employment situations create a different problem because the relationship is generally between the individual employee and the customer who directly performs the service, rather than between the customer and the employer. One San Francisco body-piercing shop insisted its piercers sign non-compete agreements.<sup>41</sup> Again, the customer relationship is normally with the artist, not the shop employing the artist. These concerns and attempts to control the future are more understandable and more difficult to enforce where workers have access to sensitive business information.

One of the greatest misconceptions regarding non-competition clauses is that Courts routinely enforce non-competition agreements. However, even the most carefully drafted provision that prohibits "competition" with a former employer may not always be enforceable.<sup>42</sup> Traditionally, covenants not to compete have been sparingly enforced because of the common law aversion to limiting a person's ability to earn a living and because they prohibit legitimate competition. Employers tend to seek to protect themselves from former employees via contracts which are broader than necessary to protect themselves from "unfair" competition.<sup>43</sup>

In the case *Uncle B's Bakery, Inc. v. O'Rourke*, the Court looked at great length at what is reasonably necessary for the protection of the employer's business.<sup>44</sup> One area that the Courts frequently examine in a non-competition case is how long the competitive activity is prohibited. There generally must be some recognizable relationship between the time restrictions and the adverse effect the competition will have on the business. If the period of time is excessive the Courts refuse to enforce the contractual provision. The Iowa Federal Court has found that a five-year time period is at the very limits enforceable.<sup>45</sup>

In general, employers in the U.S. do not have a right to protect themselves from all competition. The only protection they can obtain is against "unfair" competition.<sup>46</sup> Non-competition covenants will not be enforced if they are found to be unreasonable. As stated above, the covenant may be held unreasonable because it lasts for too long, covers too wide a geographic area, or is too broad in the types of business it prohibits.<sup>47</sup> Courts look at the necessity for a non-compete clause to protect employers' businesses and the reasonableness of the restrictions to employees. Enforcement of non-compete agreements also differs from state to state. In California, one of the few states that statutorily bars non-compete agreements, employers have to rely on other means, such as non-disclosure agreements, to protect their confidential information if competitors hire away employees.<sup>48</sup>

A non-compete agreement may also be found unreasonable because the information revealed to workers is not particularly sensitive. Thus, the restriction does not serve a valid business purpose. Judges are more likely to enforce restrictive agreements against high-level managers who are provided inside information, based on the theory that such former employees are in a position to do genuine harm to the business.<sup>49</sup>

Former employees who have signed non-compete agreements may face special hardships because their job searches may be limited. And, even those with solid job offers may face lawsuits by former employers, often accompanied by damaging Court orders forbidding them from working until the case is resolved.<sup>50</sup>

Geographical restrictions or limitations may also be found unreasonable if the defined area of prohibited conduct is "vague" or "excessively large".<sup>51</sup> The zone or area of non-competition must be identifiable and the size of the zone must relate to the employer's business and its competition.

#### **D. Mandatory dispute resolution**

A fourth provision that job applicants are more frequently being asked to sign in preemployment contracts is mandatory dispute resolution. To combat uncertain results and costly litigation, employers increasingly are requiring new hires to submit disagreements with the company to arbitration. Under these arrangements, new employees agree to forego the filing of any lawsuit(s) and submit to binding arbitration any disputes arising from, or related to, their employment. About six million employees currently are covered by arbitration agreements.<sup>52</sup>

The use of mandatory arbitration offers significant advantages to both employers and employees. In most cases, mandatory arbitration is less expensive than Court litigation.<sup>53</sup> Unlike lawsuits, where there is extensive pre-trial discovery, including depositions, interrogatories, and document production demands, arbitration proceedings are generally restricted to a limited number of depositions and document exchanges. The Court practice of filing numerous motions, often in formal fashion, is discouraged in arbitration proceedings, which tend to be more informal.<sup>54</sup> Arbitration follows a more relaxed application toward evidence rules by allowing evidence in a form, such as an affidavit, that a trial Court would exclude.

Arbitration is generally more expeditious than litigation. While lawsuits may take years to reach the Courtroom, arbitration arrangements are often completed in less than a year. Additionally, while Court cases are a matter of public record, arbitration is more private and confidential. Many Courts have taken the posture of favoring the contract that establishes a process to resolve disputes themselves, rather than seeking judicial resolution.<sup>55</sup> Employers favor arbitration because the case is decided by a professional arbitrator who, unlike a jury, is generally well versed in the law, less likely to be swayed by sympathy, and better able to appreciate a company's legitimate business concerns and objectives.<sup>56</sup> Employees generally favor arbitration because of the reduced costs and time involvement. Both parties favor compulsory arbitration because of the finality of the decision of the arbitrator. The parties have contractually agreed prior to the arbitration that the arbitrator's decision and award will be final and binding, and such a decision is seldom appealed because of the limited grounds for appeal.

Companies that consistently use arbitration to resolve disputes concerning their business tend to have an advantage over employees. James Johnson, an employment law specialist, says:

Put yourself in the arbitrator's position. Odds that the plaintiff employee is ever going to need your services again are almost zero. But if you're a large, multistate or multinational corporation, you figure 'If I give a good ruling on this case, they're going to keep shooting me these cases and I can make a lot of money'. That's a built-in bias in the arbitration procedure.<sup>57</sup>

Even with this bias, mandatory arbitration can still provide benefits to employees. Many times a business will agree to pay a greater portion of the costs if the case goes to arbitration, such as J. C. Penney Company paying 95% of the costs of arbitration.<sup>58</sup> Also, there seems to be a tendency for arbitrators to "split the baby" by giving plaintiffs more than they might have received in Court.<sup>59</sup>

In March 2001 the U.S. Supreme Court reinforced an employer's right to require mandatory arbitration of disputes with its workers. The Supreme Court in *Circuit City Stores Inc v. Adams* held in a 5 to 4 decision that employment and preemployment agreements containing arbitration provisions are enforceable under federal law.<sup>60</sup> In that case, the employee had signed a preemployment agreement in part agreeing to submit all employment disputes to binding arbitration. Employers and employees, therefore, have a reliable alternative to courtroom litigation as a means to redress employee complaints. The decision gave broad protections to arbitration agreements and provided the parties with good reasons to consider instituting mandatory arbitration programs. Indeed, after the *Circuit City* decision, the number of companies with compulsory arbitration clauses in their employment contracts nearly doubled.<sup>61</sup>

Further legal guidelines for mandatory dispute resolution appear to be developing, though not always in a predictable or consistent manner. On January 15, 2002 the Supreme Court ruled in *EEOC v. Waffle House, Inc.* that a federal agency can file lawsuits on behalf of employees who have claims under the Americans with Disabilities Act (ADA), irrespective of a signed employment contract that provides for binding arbitration of all employment disputes.<sup>62</sup> The Court distinguished between the "causes of action" of the employee and the "causes of action" of the EEOC. The employee can contract away the settlement of his/her "cause of action" in an employment agreement, but this (contractual waiver) is not binding on the EEOC because of the public policy consideration. The decision reinforced the power of the EEOC to file suit in cases of "public interest" and somewhat limits the power of business to keep workplace disputes out of Court. The EEOC saw this as a victory for their long-held belief that such agreements are inconsistent with civil rights laws.<sup>63</sup> The Supreme Court basically held that a claim under the statute was enforceable by both the employee and the EEOC, and the waiver of the employee's claims to file suit in federal Court does not preclude the EEOC from filing suit. The legal causes of action are separate and exclusive of one another, even though they are derived from the same statute.<sup>64</sup>

The decisions in the above two Court cases underscore the often-conflicting principles in the treatment of mandatory arbitration on employment disputes by the Courts. On the one hand, the use of arbitration and alternative dispute resolution mechanisms is encouraged as a matter of public policy. On the other, some Courts and legal commentators caution that mandatory arbitration may erode employees' statutory rights or the authority of agencies to enforce those rights. However, the EEOC decided to file or join a lawsuit in only 402 of the 79,896 charges of job discrimination it considered in 2000,<sup>65</sup> and the EEOC only filed 430 cases in 2001 and 364 in 2002<sup>66</sup> thus suggesting the chances of litigation with the EEOC are remote.

The employer must consider that it is very rare for a Court to reconsider or overturn an arbitrator's award. The burden of proof required for overturning the award is very high. The appealing party has the burden of showing by clear and convincing evidence that the arbitrator acted in an "arbitrary and capricious" manner.<sup>67</sup> The Courts generally look to whether there is any evidence to support the arbitrator's decision, not whether it may have been the best evidence. The finding of any evidence that supports the findings of fact by the arbitrator is generally enough to uphold the arbitrator's award.

## **E. Non-solicitation**

A final preemployment agreement addresses the issue of "non-solicitation" clauses. Employees, particularly in service businesses, inevitably develop special relationships with the business clients and

customers. Non-solicitation agreements are provisions in which employees agree not to solicit the present or past employer clients and customers for their own benefit or for that of a new employer. Non-solicitation agreements may be part of a larger employment agreement, a non-compete provision, or a non-disclosure clause within an employment contract. Non-solicitation provisions are one of the vehicles used to avoid restrictive state laws (e.g., California) that prohibit “non-competition” clauses, and therefore a non-solicitation clause or agreement may be the only way to discourage employees from going to work for competitors, opening a competing business, or contacting customers or clients by a subsequent employer.

There are limits to the application of non-solicitation agreements, however. As with non-competition clauses, Courts are less willing to enforce non-solicitation agreements which severely limit employees’ ability to earn a living or unfairly limit legitimate competition.<sup>68</sup> Generally, Courts look at organizations’ and employees’ circumstances to judge whether non-solicitation agreements are fair. The key is the “reasonableness” of the non-solicitation agreement. If a judge thinks the agreement is overreaching or too broad, the Court may refuse to enforce the provision. Judges want to see justification for restraint on the employee’s ability to pursue a career. A valid business interest is one of those justifications. Valid business interests may include protecting a customer list an organization has spent years amassing. On the other hand, if the customer list is not unique and could be compiled by just looking in the *Yellow Pages*, a Court would likely not enforce a non-solicitation agreement against a former employee. Other valid business interests include trade secrets, production formulas, and specific business processes. In general, non-solicitation agreements do not and cannot prevent a client or customer from voluntarily moving to a competitor. If customers want to take their business to a given competitor and have not been improperly solicited by a former employee, a non-solicitation agreement probably would not be enforced.<sup>69</sup>

### **III. Employee Considerations**

Job candidates/employees must understand that preemployment agreements are not only about protecting employers, but they may also protect employees. Contracts can benefit both parties by clarifying employment relationships between the employer and employee. As in any contract violation, the contract may be enforced in Court. Additionally, employees do not need an agent to negotiate on their behalf, but they do need to carefully and fully read and understand the contract prior to signing. Negotiating points need to be thought out and anticipated over the terms of the agreement. Contract clauses can include duration of the contract, bonuses, salary, vacation, education and training, stock options, and health benefits. A prospective employee may consider asking for a clause specifying how employment can be terminated. The last point can be particularly beneficial for potential employees because it requires employers have just or good cause to terminate.<sup>70</sup> Many states are “employment-at-will,” where the employer can terminate an employee for a reason or no reason, as long as the employer is not violating a state or federal law.<sup>71</sup> “Just cause” agreements generally specify that contracted employees can only be terminated for specific reasons, such as a breach of an essential term of the contract or not attaining production or sales goals.

It is critical that applicants read and understand everything contained in the preemployment document. If they do not, applicants could be signing away important rights that affect their livelihood and long-term well-being. If they enter into contracts without reading the provisions they are still bound to the contractual terms.<sup>72</sup> Applicants should ask questions, including the following: What are the penalties if one leaves before the contract ends? Is this a “just-cause” or “employment-at-will” clause? What are the conditions of termination? What are the severance pay and benefits if the company terminates the employee without cause? If the company merges, would the employee be guaranteed a severance package? If the company wants to relocate, will the employee be compensated for moving? and, When does the contract expire or is it automatically renewable?

It is clear that preemployment contracts cannot waive certain employment rights established under federal or state law.<sup>73</sup> For example, if employers are required to pay workers overtime, based on the Fair Labor Standard Act, employees cannot be required to sign contracts waiving these rights.<sup>74</sup> Even if employees have contracts, employers are still subject to most laws regulating wages, prohibiting discrimination and sexual harassment, requiring accommodations based on disabilities, imposing health and safety standards, providing medical and family leave time, and worker’s compensation and unemployment benefits.<sup>75</sup>

Applicants may be excited about working for a company and sign a contract thinking everything will work itself out. This is not always true and the employee may have to work under the conditions of the contract. For this reason, it is important that applicants not be intimidated into signing employment contracts quickly.<sup>76</sup> It is often very beneficial to have an attorney review such documents and explain anything that is unclear. Considering that companies usually have their attorneys draft and/or review such agreements, potential employees should not sign legally binding contracts without first seeking input from legal counsel.

Just how good a contract can be negotiated depends largely on how desirable the employer considers the individual and attendant skills. According to employment attorney James Johnston:

The more they need you, the more likely it is you're going to get clauses that you want in the agreement. ...if there are five other qualified candidates for the same position—you have little leverage and may be justifiably wary of negotiating yourself right out of the job.<sup>77</sup>

The key for employees is determining how much leverage, if any, they have. Employees must determine whether their knowledge and skills are unique and in demand. Attorney Paul Tobias advises:

If you sense you have bargaining power, you can write your own ticket. If they're very marketable and they know they can go to another job just as easily as this one, then I tell them to push for the max. On the other hand, if the person isn't at that standpoint, I counsel them to feel out the situation and kind of bring up the subject if they feel comfortable.<sup>78</sup>

Ultimately potential employees makes decisions whether to accept employment and under what conditions. Understanding preemployment agreements will facilitate decision-making and the effects of the agreements in both the short- and long-term.

#### **IV. Employer Considerations**

Several preemployment agreements have been presented: 1) training expense reimbursement, 2) non-disclosure of business information and trade secrets, 3) non-competition by the employee, 4) mandatory arbitration or mediation, and 5) non-solicitation. Certainly, use of a single agreement may benefit an organization, however, quite often firms may profit from synergies generated by the use of multiple employment agreements. When designing a comprehensive preemployment program several key areas must be addressed.

##### **A. Identify the business interest that needs protection**

What needs to be protected if employees end employment? Each business is unique and so are the interests of that business which need protection. Generally, the business interest will fall into one of the five categories as set forth above. A careful examination of the company's history, goals, competitive advantages, and business objectives will provide insight into the types of employment contracts that might be particularly beneficial to a specific organization. The business must seek protection internally (employees) and externally (clients, partners, vendors and other business contacts). Utilizing preemployment contracts will provide protection in internal cases, but only non-disclosure agreements will provide protection from external sources. One must be clear about what one needs to resolve before one can construct a contract to do so.

##### **B. Assess the benefits**

Consider the benefits of utilizing preemployment and non-disclosure agreements against the risks. The protection of the proprietary business rights or interest may be the only way to protect a firm from the competition. Therefore, asking employees to sign employment or preemployment contracts may be worth the effort. The larger the business the greater the time expenditure will be to receive the benefit of the contract. Also, each person with whom an employer does business may be required to sign a non-

disclosure. A determination has to be made as to the risk of the competition obtaining the business interest. If the risk is minimal it may not be worth the effort. If the risk is great the decision is easy. The difficult decision will be determining if the risk of the competition obtaining the information is somewhere between.

### **C. Review the applicable state law(s)**

Know the laws affecting the business. Preemployment contracts will generally be litigated or interpreted under state law. Therefore, strict compliance with the principles of contracts is essential. A valid and enforceable preemployment contract must meet all the statutory requirements as well as the public policy concerns of the state or states where the business operates. Some states prohibit the enforcement of certain types of employment provisions (e.g., Connecticut and Michigan prohibit promissory notes to recoup training costs) or other conditions that may be agreed to by employers and employees.

### **D. Tailor the contract provisions**

Fit the contracts to business needs. Contracts should not be overly broad. They must protect the interests of businesses without overly restricting employees' rights (e.g. to employment). Design arbitration clauses to eliminate or substantially reduce the possibility of litigation. Placing contract restrictions or agreements in employee handbooks should have the same effect (legally) as a separate and independent agreement.

### **V. Summary and Conclusions**

This article addresses the basic contract requirement for preemployment agreements and outlines specific requirements for the five most litigated preemployment contract clauses. Employers who are concerned with protecting the company's intangible business interests from potential "abuses" and "unfair competition" by former employees should consider utilizing preemployment agreements. In the future, employers may want to develop preemployment contract clauses which address other areas such as electronic monitoring, substance abuse, sexual harassment, violence in the workplace, worker's compensation, background and credit checks, Internet use, and many others. The foresight of employers to predict adverse business effects that employees may have on the firm if they leave will be the only limitation on the potential use of preemployment agreements.

A properly drafted preemployment agreement eliminates the ability of the employee to successfully argue that the agreement is either "unconscionable," "overly broad," or "a violation of public policy." In general, the vast majority of the cases involving preemployment agreements show the Courts willingness to enforce such agreements, provided they pass the above tests. Once an agreement has passed these tests it should be and will be enforceable.

### **Footnotes**

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