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EMPLOYMENT CONTRACTS: NAVIGATING END-OFTERM CHALLENGES FROM DAY ONE

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1 Introduction

"Prepare for the worst…"

The origins of this phrase aren't easily identified, aside from it potentially being attributed to Benjamin Disraeli, a former British PM in the 1860s. Nonetheless, it is certainly a phrase worth remembering when drafting employment agreements.

This is because there are generally two occasions when the parties will look at the contract in an employment relationship; first, when they sign it, and second, when either party is contemplating or has already begun the process of terminating the employment. This is why it is so important to get the drafting right from day one, with particular attention given to the termination related clauses, so as to prepare for the end of the relationship. In preparing for the inevitable end of the relationship, it is first important to understand what objectives should be considered, as this will inform what types of clauses will be required.

2 Objectives of an appropriately drafted employment agreement and termination related provisions

+ Protecting the employer's interests – Intellectual property (IP), confidential information, reputation, customer connections and goodwill.
+ Establishing guideposts and obligations on the employee that apply at the time of termination of the relationship, and after the relationship has ended.
+ Minimising disputes/claims from employees about their entitlements on termination and the termination process generally.
+ Setting a clear process and requirements for how the relationship can be ended.

With the above objectives in mind, employers should then consider what clauses must be included in their employment agreement to best achieve those objectives.

3 Protecting the employer's interests

The types of information and interests that are protectable by an employment contract (and other sources of law, such as implied terms and legislation) are an employer's:

+ IP.
+ Confidential information.
+ Reputation.
+ Business interests (such as its goodwill and connection with customers, clients and suppliers).

Intellectual property (IP)

Disputes and claims on IP will often arise after the employment has ended, where for example, an employee has developed a valuable piece of IP during their employment, and that employee then resigns and goes on to realise the value of that IP with another entity or for their own benefit. For this reason, it is important for IP clauses to be drafted appropriately to protect the employer's IP during and after the employment relationship.

The general position under Australia law is that the employer will own any IP created during the course of employment. However, the concept of what is in the *'course of employment'* isn't always clear. For example, an employee working for a bank on product development, would generally not have a claim on any IP created by the employee on these products, whether that occurs during normal business hours or whilst the employee came up with the solution on their morning exercise routine. However, say the employee was working for a separate start-up business during his own time, and happened to develop a new product for this start-up during his lunch break at the bank, and using the bank's laptop, would the bank have a claim on the IP?

The answer will depend on how broadly the employment contract defined the employee's duties and software development obligations, but it seems unlikely.

The key factor a court will consider is whether or not the employee had a duty to create IP in the relevant field as part of their employment. Someone employed to create IP in the normal course of their duties is unlikely to be able to claim personal ownership in IP that is relevant to their work. However, an employee who is not employed to create IP, but does so, will have a greater chance of staking their claim. The way the employment contract is drafted can be determinative – particularly, the duties of the employee.

A common issue is the failure to include any duties at all in the contract, or where the contract simply says "*the duties are consistent with that of a software engineer*".

To deal with that elastic concept of when IP is created in the *course of the employment*, most appropriately drafted employment agreements will include a clause that captures any IP created by the employee:

+ in the course of the employment;

+ during the period in which the employee is employed by the employer, which relates in any way to the confidential information or other information or property of the employer or its related bodies corporate; or

+ using the employer's resources.

The other common pitfall is where the IP assignment provision (where the employee agrees to assign any IP created by them, to the employer) is not expressed to survive termination of the employment. Without this, the employee will have no ongoing obligation to take all necessary steps to give effect to the employer's ownership of the IP. Employers should also consider including any cooperation clauses, which would require assistance and cooperation from departing employees in relation to the prosecution or defence of IP rights.

Confidential information

The drafting of confidential information provisions in an employment agreement are critical to state the various obligations on employees with respect to the precise confidential information the employer wants to protect. The material components of an appropriately drafted confidential information provision are:

+ *Clear scope of confidential information*: Employers should have a sufficiently broad definition of confidential information – making sure it extends to not only the employer, but also any related bodies corporate in the broader group (if applicable), and any confidential information of clients and customers.

+ *Non-disclosure obligations*: There should be clear provisions on non-disclosure obligations,– including any precautions that must be exercised by employees in regard to using, storing and disclosing such information – i.e. it can't be sent to their own email or stored on unsecure locations.

+ *Termination obligations*: The obligations on termination of employment should be clearly set out in the agreement, and expressed to survive termination of the employment. Employers should consider whether they want all information deleted by the employee, whether the employer needs additional protections like the employee's devices being returned and forensically analysed, or whether any of the employee's personal devices (such as any '*bring your own devices'*) need to be forensically wiped before the employee retains it.

Common pitfalls in drafting include:

+ Failing to sufficiently capture all necessary information, such as passwords and platform user access details.

+ A clause that is not broad enough to capture the different forms of information, such as those kept electronically and in hard copy.

+ Failing to include the necessary exceptions to the obligations on employees, such as the right to disclose confidential information if required by law or as is necessary for the performance of their duties.

+ Not expressly stating that the obligations in respect of confidential information will survive the termination of the employment and agreement (including where the contract is terminated due to a repudiation of the contract by the employer). The *Corporations Act 2001 (Cth)* provides some protection on this point, but these protections are unlikely to be as effective as appropriately drafted contractual terms. Further, the equitable duty of confidence can provide protection to an employer's confidential information during the employment and following termination of the employment. However, express terms in a contract mean that an employer can protect information that may not necessarily meet the elements of confidentiality under the *Corporations Act 2001 (Cth)* or equitable duty of confidence.

+ Obligations on the employee to delete all confidential information, which may, in some circumstances, be prejudicial to the employee where such information is the only source of that information. Flexibility should be incorporated into the drafting to ensure the employer can give different directions as considered necessary.

+ Despite the provisions of a contract, employers often do not enforce the deliver up obligations in the employment contract upon termination, following which they later discover that the confidential information has been unlawfully disclosed or misused by the employee. This is the reason why termination letters should always include a reminder of these continuing obligations around non-disclosure and return of confidential information.

In addition to the above recommended contractual provisions, any information technology or computer usage policies can also be suitable for the employer to include any required practices and protocols regarding the employee's use of its confidential information, as a supplement to the core obligations in a contract. The benefits of it being in a policy allows the employer to vary these policies from time to time, without having to

get the employee's consent to vary their employment contract. However, the employment contract would need to include an obligation on the employee to comply with such policies. These policies would also need to be made readily available to employees, and ideally acknowledged by the employee from time to time (such as on induction or periodically during their employment) that they have read and understood the policies.

Reputation

Properly drafted employment agreements will usually include:

+ A general duty on the employer to act in the employer's best interests, and to refrain from any conduct which adversely impacts the employer's interests.

+ A provision which allows the employer to terminate summarily without notice if an employee breaches the above obligations.

+ Non disparagement obligations that apply both during and after the employment ends, which prohibits the making of disparaging or unfavourable remarks about the company or its employees or directors.

A common pitfall is where the non-disparagement obligation operates during employment, but are not expressed to continue after the employment ends.

The employer' business interests (post-employment restraints)

Post employment restraints are common in Australian employment agreements. However, non-compete clauses and other restraints of trade are, as a general rule, contrary to public policy and void unless they are justified by special circumstances in a particular case. Further, certain foreign jurisdictions (such as the US) are beginning to prohibit or limit the use of such restraints. The Australian Competition and Consumer Commission is also considering their use, and recently took submissions on the anti-competitive impacts of such restraints, which may also have an effect on the use of such restraints in the future.

Whether any of the restrictions are enforceable will depend on whether the employer is able to establish that:

+ it has a legitimate business interest to protect by way of a restraint; and

+ the restraint goes no further than is necessary to protect that legitimate business interest.

Legitimate business interests in an employment context will either be the protection of confidential information or customer connections. An employer is not entitled to be protected against mere competition.

A basic requirement of any contract is that there is adequate consideration for the agreement reached. This principle also applies in restraint cases. However, there is no principle that employees must receive remuneration equivalent to the period of restraint for the restraint to be enforceable. Where an employee will suffer no financial loss in being restrained, this will be taken into account by the court and is persuasive.

In all states of Australia except New South Wales (NSW), unreasonable restraints will not be enforced, and will generally be voided in their entirety if the contract itself does not allow for a reduction to a more reasonable and enforceable restriction. In NSW, the position is different because of the *NSW Restraints of Trade Act 1976* (NSW) (RTA). The RTA empowers the NSW Supreme Court to read down and effectively amend an unreasonable restraint in the context of an actual breach; for example, a court may find

that an employee should be restrained for three months in NSW rather than six months. As a result, most employment contracts outside of NSW will have cascading restraint periods and areas (i.e. from 12, 9 to 6 months) that can be read down or reduced by a Court, rather than voiding the clause in its entirety.

Common pitfalls in restraints provisions are:

+ Uncertainty when the restraint period commences and ceases. The drafting should be precise as to when the restraint commences, which is usually on the date of termination (i.e. the last day of employment), as opposed to when notice is given or when any period of garden leave commences.

+ Imposing a geographical restraint area on the non-solicit obligations. It is common and improves the reasonableness of a restraint to apply a geographical area to a non-compete restraint. By contrast, if a restraint area is applied to a non-solicit obligation, the employee could temporarily remove themself from that specified area and engage in the solicitation of clients or employees, without necessarily breaching the restraint. For this reason, applying a restraint area on a non-solicit obligation is not recommended.

+ Broadly drafted and unenforceable provisions. For example, a non-compete restraint that purports to restrain an employee for working for a competitor anywhere in Australia (even though the employer only operates in the Queensland market), will likely be deemed unenforceable.

+ Prohibitions that prevent a person from taking up employment with a competitor, but do not go as far to prevent them from being engaged as a contractor or acquiring an interest in or investing in a competitor. These limitations in drafting can create simple work arounds for employees.

+ Uncertainty in drafting. A restraint that is uncertain as to the extent of its intended operation can be deemed unenforceable. For example, a restraint that includes various cascading restraint periods and areas, and multiple combinations of how they can apply, may be deemed uncertain. This is why it is important that such restraints include provisions on how the restraints are to be applied – for example, it is important that the provision explains:

  – That each provision, resulting from the combinations of restraint areas and restraint periods, is a separate and independent obligation from the other restraint obligations imposed, but they are cumulative in effect.

  – The parties intend the clause to operate to its maximum extent.

  – The employment is adequate consideration for the restraints.

4 Termination arrangements and payments

Termination related provisions are critical to ensure absolute clarity on the arrangements in a termination scenario, including what payments and benefits must be paid and provided to employees, and what obligations apply to the employee immediately on termination. This will minimise disputes with departing employees regarding their entitlements, and if correctly drafted, will give employers sufficient flexibility to determine how the employee's termination will be managed.

Termination with notice

Firstly and most obvious, the contact should include a provision that allows either party to terminate the agreement with written notice or a payment in lieu of notice (unless it is a

genuine fixed term contract). This notice period must at least be above the minimum amount of notice as required under the *Fair Work Act 2009* (Cth) set out below:

Employee's period of continuous service	Minimum period of notice
Not more than 1 year	At least 1 week
More than 1 year but not more than 3 years	At least 2 weeks
More than 3 years but not more than 5 years	At least 3 weeks
More than 5 years	At least 4 weeks

An additional week is provided to an employee aged 45 years or older and has at least two years' continuous service.

Prescribed notice processes

Historically, some employment contracts will include prescribed processes for giving of notice, such as it being delivered to a particular address of the employee and/or the form in which must be delivered, i.e. in writing, in person or over email. These provisions are becoming less common. If these provisions are included, sufficient flexibility should be given to the employer to give the notice in various forms, and to minimise the risk of ineffective notice if these prescribed provisions are not complied with.

Risk of reasonable notice

In the absence of an express term (or written contract all together), some employees may argue that there is an implied term of reasonable notice. Depending on factors such as the length of service, seniority and age, this could include a claim for periods of notice that are well in excess of the statutory minimums and can be as high as 6 to 12 months, or longer in exceptional cases. The authorities on reasonable notice suggest that any modern award (if applicable) and s.117 of the *Fair Work Act 2009* (Cth) may “fill the gap” where there is no express notice period, therefore, there is no need to imply a term of reasonable notice. However, the authorities on this point remain somewhat inconsistent, which reinforces the point on having a clear notice provision in all contracts.

No payment in lieu of notice clause

A common pitfall is where the contract does not allow the employer to make a payment in lieu of the notice period. In that case, an employer will technically be in breach of the employment agreement if it made a payment in lieu of notice to the employee instead of the employee working out their notice period. However, in practice this would not usually create material legal risk for the employer. This is because the damage suffered by the employee in not being able to work out their notice period would most likely be equivalent to the payment in lieu of notice they have received. The exception to this is if the employee had worked out their notice period and they would have received other bonuses, commissions or incentives in excess of the payment in lieu of notice they otherwise received. Consideration should be given to employees in this category before such payments in lieu of notice are paid.

What is the rate of pay?

It is important a payment in lieu of notice clause is clear on the rate of payment it is calculated on. For example, it will generally be calculated on base salary, in addition to superannuation (which is legally required to be paid on any payment in lieu of notice).

However, care needs to be taken when employees are covered by a modern award or enterprise agreement or where the notice periods are close to the *Fair Work Act 2009* (Cth) minimum periods of notice which require such payments to be equal to the *full rate of pay* the employee would have received if they worked throughout the notice period. This is inclusive of any incentive-based payments and bonuses, loadings, monetary allowances, overtime, penalty rates and any other separately identifiable amounts.

Flexibility during the notice period

Appropriate provisions should be included to provide the employer flexibility to:

+ require them to work, including on modified duties, or not work at all;
+ direct the employee onto garden leave (i.e. remain away from the employer's premises, refrain from contracting employees and customers but otherwise remain contactable for any business needs);
+ make a payment in lieu of notice and finish their employment immediately; or
+ a combination of the above.

Summary dismissal provisions

The summary dismissal provisions, depending on how they are drafted, can displace or modify the right under common law for an employer to summarily dismiss an employee for misconduct. This can include either the broadening or narrowing of the common law right. For example:

+ *Narrowed*: In in *Willis Australia Group Services Pty Ltd v Mitchell-Innes [2015] NSWCA 381*, the Court found that the contract narrowed the common law right because it included a two-step process of determining whether misconduct justified summary dismissal, being:
  - whether the conduct was serious misconduct; and
  - then a further consideration of whether the serious misconduct was serious enough to justify dismissal.
+ *Broadening*: In *Bartlett v Australia & New Zealand Banking Group Ltd (2016) 255 IR 309; [2016] NSWCA 30,* the Court found that the contract of employment had broadened the common law definition of misconduct justifying summary dismissal. The terms allowed the employer to terminate summarily where:
  - the employer held an opinion that the employee had engaged in serious misconduct; or
  - the employee breached any term of the contract (rather than the common law requirement that a serious breach relate to an essential term of the contract).

Careful consideration must be given to ensuring the common law right is not narrowed or muted by the express provisions of the contract.

5 Specific actions required on termination

Employment contracts should further include express obligations to:

+ pay or repay to the employer all sums which the employee owes to the employer (such as any loans, overpayments or cash advances); and

+ return all company property, including any confidential information.

For any senior executives and directors, employment contracts should include further provisions:

+ requiring the employee to, at the request of the employer, resign from any office (including that of Director) held by them; and

+ acknowledge they will not be entitled to receive any payment or benefit that would mean the employer contravenes ASX Listing Rules or s 200B of the *Corporations Act 2001 (Cth)*, which is the prohibition on certain termination benefits that exceed the specified cap, unless shareholder approval is obtained.

6 Conclusion

The parties to an employment agreement will often only focus on the key terms that are relevant at start of the employment relationship, such as remuneration, bonuses, location and reporting lines. However, knowing that the often most analysed, critiqued and disputed clauses of an employment agreement are likely those relating to termination, "*preparing for the worst*" is often a good mindset to apply when drafting an employment agreement.

Employers should create a checklist (such as the one suggested below) to ensure they are considering each of these material provisions that relate to termination. This will assist in protecting the employer's interests, and minimising disputes with departing employees.

7 Example checklist

Employers should consider whether the employment contract includes the following:

+ Appropriately drafted **IP and confidential information** clauses. Are the duties included in the contract or a separate position description?

+ Appropriately drafted **post-employment restraints and non-disparagement** obligations? Having regard to the position of the employee, is a post-employment restraint in practice required?

+ **Termination with notice provisions**, and **flexibility** for the employment to make a **payment in lieu** or direct the employee on **garden leave**?

+ Is it clear what the **employee's obligations on termination** are, particularly as they relate to confidential information and company property?

+ Are all of the provisions above **expressly stated to survive termination**? Have employees been **reminded** of these obligations and steps taken to retrieve any confidential information and company property?

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