Lowenstein Sandler's Employee Benefits & Executive Compensation Podcast: Just Compensation

Episode 28 – Best Practices for Successful Employee Onboarding

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Taryn Cannataro: Welcome to the latest episode of Just Compensation. I'm Taryn Cannataro, counsel in Lowenstein's Executive Compensation and Employee Benefits Group. And I'll turn it over to my colleagues to introduce themselves.

Megan Monson: My name is Megan Monson. I'm a partner in the same practice group as Taryn.

Julie Werner: This is Julie Werner. I'm a partner in our Employment Practice Group.

Amy Schwind: And I'm Amy Schwind. I'm counsel in the Employment Practice Group.

Taryn Cannataro: Today's discussion will focus on best practices when onboarding new employees and recent legal developments that may impact how a company approaches this process. A well-thought-out hiring process can help companies not only attract and retain top talent, but it can also help companies meet legal obligations, obtain necessary protections, and avoid costly mistakes such as employee misclassification. We'll focus on a few key areas that companies often have questions about in this area. As always, this is not intended to be an exhaustive discussion, so we encourage you to consult with your legal counsel if you're looking for advice in this subject matter. Julie, Amy, can you provide us with a high-level overview of some key documentation that a company should have in place when seeking to hire new employees?

Amy Schwind: Sure, Taryn. So first, the employer is going to want to have offer letters to extend an offer of employment-to-employment candidates. Typically, that offer letter will state that the employment is at will, although the employer might want to consider an employment agreement. And typically, that is for employees who are higher level or executives, so that's something to think about. The employer will also want to have in place covenants agreement with employees, and that agreement typically includes confidentiality provisions, invention assignment. And it can contain, although there are certain requirements that vary by state on this, it can contain non-compete obligations and non-solicit of clients and non-solicit of employees.

There are other onboarding documents that an employer would want to have in place. Typically, an employer will include employment policies and an employee handbook, and the time to distribute that to employees would be at the time of hire. And the employer would want to obtain an acknowledgement form that the employee

received those policies. Also, many states have required notices that need to be distributed to employees upon hire, and so that varies depending on the state. Some states have what's called wage theft notices, which is sort of a scary name but it's typically to inform employees of their rate of pay and when they will be paid. An employer will also want to make sure that all of its employees are authorized to work in the United States. And so to complete the I-9 process properly.

There are certain tax forms that would be distributed at hire and filled out. Also, a direct deposit authorization form to initiate payment to the employee by direct deposit, there are benefits, enrollment forms and information that would need to be put in place. Also, if the employee is going to be paid by commission, the employer would want to have written commission plan in place. And also, along the lines of notices, just a note that New York State somewhat recently effective May 7th, 2022 has a requirement for an electronic monitoring notice. If the employer has a place of business in New York and it monitors or intercepts an employee's phone conversations, emails or internet access or usage, there needs to be a notification to the employee. And so that time to do that would be at hire.

Megan Monson: We know a lot of the items that you just touched on are required by law. But there are also others such as the offer letter, employment contracts that are really best practices to have so that there's a clear delineation of what the obligations are, and that the company maintains flexibility to make changes to the employment arrangement. In the course of diligence if a company's being purchased or sold, there's a lot of scrutiny into the terms of offer letters, employment contracts, and covenants agreements both for purposes of understanding whether they are legally enforceable, but also if there is flexibility to make changes.

Amy Schwind: Yep, absolutely.

Taryn Cannataro: So one of the things that you touched on, Amy, is the importance of documents governing the terms of the relationship. When would you use an offer letter versus an employment agreement?

Julie Werner: So I can answer that one. I would say the starting point typically should be an offer letter. And as you said, you want to have flexibility but certainly you want to be clear upfront mainly what are the terms and conditions of employment compensation, most notably. So whether it's in an offer letter, whether it's in an email, certainly in some written communication at a very base level, the terms and conditions of compensation should be spelled out in writing. When executives typically are negotiating for their employment, there is often an expectation of there being a more formal employment agreement. Whether or not that really is necessary or required depends on the specifics of the situation. And sometimes it's really more of an expectation that an executive may have, but it's certainly not required.

Companies may do it to try to make an attractive offer, but it really is typically something that is more favorable for the employee. It's certainly, ultimately is setting forth compensation and other sorts of perks that are typically more advantageous for the employee than the company. So I would say that most companies should start with the premise that an offer letter is sufficient. And that should be the typical starting point unless there are some other commercial or business reason to have a more expansive contract.

Taryn Cannataro: Thanks, Julie. That's some great points that you pointed out. You had mentioned covenants agreements earlier. In terms of covenants agreements, can you provide us with some best practices and common pitfalls to be aware of for those documents?

Julie Werner: So typically covenants agreements, as Amy mentioned earlier, would include base levels of confidentiality as well as assignment of inventions. And depending on the circumstance, a non-compete or a non-solicit. Confidentiality is something that virtually every employee should be required to sign because there is likely proprietary information, business information that an employer would want to keep confidential. And although employee handbooks will contain language often as a policy because that's not legally binding, that is it's more informational than contractual, having an employee sign a base confidentiality agreement is important. In addition to that, many employees in their roles will create work product that belongs to the employer.

And so while there is a common law concept which is known as work for hire that is sort of a base level that otherwise would apply, it is typical and especially for more advanced companies in the tech space. And Megan, you were mentioning diligence earlier, it's expected oftentimes in transactions that companies will have had formal assignment of inventions agreements signed by employees. And then lastly, the concept of a non-compete or a non-solicit is a very fact specific inquiry that will depend on the level of the employee, what legitimate business interest the employer has in potentially restricting that person post-employment from engaging a certain behavior. And it will really vary very much state by state in terms of whether that's permitted. I believe you guys recently did a presentation on non-compete law in another podcast, and the law continues to evolve.

I'm not exactly sure when you last did that, but I think even Minnesota as of July 1st now is prohibiting non-competes. I don't know how many people from Minnesota are listening, but it just shows you really week by week the law continues to evolve. There's a bill that's pending in New York that was passed by the legislature that is awaiting the governor's signature. We're waiting to see what she does with respect to the bill, but it really is something that should be customized. The idea of using a basic form while it was attractive as a concept doesn't really work anymore, because there's so many different state specific nuances and so that requires scrutiny depending on the employee and the specific situation.

Taryn Cannataro: And I guess a quick follow-up question, Julie, in terms of the non-disclosure obligations, would it be safe to say that it's typical for those to be perpetual in nature, assuming that they're narrowly tailored enough to really protect the confidential information of a company?

Julie Werner: So yeah, look, information at some point becomes stale and obviously typically confidentiality agreements will say, the information as long as it's not public and has some proprietary value whether or not you learn something 10 or 20 years ago that may now be obsolete. I think it would be hard-pressed for a company to actually sue to enforce the restriction. But it is fairly common for it to be perpetual as it relates to confidential information.

Taryn Cannataro: That's helpful. Another hot topic that you hear frequently discussed is misclassification of employees as exempt versus non-exempt under the Fair Labored Standards Act. And I know this is an area that there's become heightened scrutiny and in particular in the diligence process, if a company is being purchased. Can you provide very high-level overview of the relevant requirements for being exempt, and the risk for failing to properly classify an employee?

Amy Schwind: Sure. So the starting premise is really that unless an employee falls into a minimum wage and overtime exemption under federal and applicable state law, the employee must be paid at least minimum wage for all hours worked and must be paid overtime hours worked. And the employer also needs to track non-exempt employees' hours worked. So there are certain distinctions and requirements, particularly as they relate to non-exempt employees that come into place. So the classification is important to

do the classification properly. It is a legal test, and I won't get into all of the details of it. But essentially under the federal test it's a salary plus a duties test. There are what are commonly referred to as white collar exemptions, and so there's a certain salary threshold that the individual needs to make to qualify for the exemption as well as certain duties. And so there's the federal law, and then there are also state laws.

And so certain states expressly adopt what the federal law does, and then certain of them also have their own laws that differ a bit and actually have higher thresholds and differently worded tests. So important to know that the person would have to qualify as exempt under both the federal law and then whatever the applicable state law is. In terms of potential liability for improperly classifying an employee, there could be claims for unpaid wages, for unpaid overtime. And there's the potential for civil fines, tax liability and penalties, criminal penalties, even in certain states there would be the potential for directors and officers' personnel liability or shareholder liability. So there can be significant consequences for not properly classifying employees, and particularly not paying overtime if the person is working overtime and should have been classified as exempt.

In practice the way that I see that this oftentimes arises is if there is a company that's starting out and wants to pay its employees only by equity, this would typically be a violation of wage and hour law. And it would not be permissible to only pay employees equity and not be paying them at least minimum wage for every hour worked.

Megan Monson: The other point I'll add is, again, in kind of the course of diligence I often see companies that just say, "Somebody's getting a salary, so we're going to treat them as exempt." But they're not looking at any of the other elements that Amy talked about. And so it just may be an oversight in terms of their administrative processes. And so it is really important to have this built into your hiring practices so that it's being looked at and evaluated on an individual basis as people are hired, and as the business grows to avoid there being any sort of risk or exposure down the line.

Taryn Cannataro: Maybe worth reiterating that it's important to look at this at both the federal and state level. In some states like California for example, the salary test is almost double the federal salary test, so it's really worth checking the state as applicable to you. While we've been focusing on new hire best practices, it would be remiss to not briefly touch on another common issue, independent contractor versus employee classification. What should a company consider when making a determination of what classification is appropriate?

Julie Werner: So in the same way that the starting presumption is that an employee is considered non-exempt unless and until essentially proven otherwise. The starting presumption also is that a worker is an employee unless and until they could prove that they are an independent contractor. So you mentioned Amy, that a lot of startups typically if they don't have cash, want to pay their staff equity, and typically that's not permissible unless the person has a certain percentage ownership of the company. Likewise, it's typical for many startups in particular that when they bring on new workers that they want to treat the person as an independent contractor. But there are tests, and the tests are extremely confusing because there are multiple agencies, federal agencies that all seem to want to impose different tests, as well as of course all the various state laws.

So typically, the most conservative thing to do would be to follow what's called the ABC test which is followed by California, which got a lot of attention on it. As well as Massachusetts and New Jersey, I believe all follow the ABC test. But even absent the ABC test formally in those states, those are the main concepts that typically are examined when looking at whether or not somebody meets the test to be an

independent contractor rather than employee. For example, the level of control, the economic independence or dependence that the person has on the company. And ultimately sort of whether or not the work they do is the crux of what the company does. So for example, this is the classic example of Uber. So as Uber would argue that it's not a transportation company, Uber would say we're a technology platform and what's integral to our business is our technology.

The drivers are sort of attendant to the business where other people... And this has been going on for ages in terms of cases and you would think there would be a definitive answer, but it still feels like in the courts it keeps coming up in different states and other things keep coming up. But essentially Uber, is the crux and heart of the business, the drivers and the transportation or is it the technology? And that's just an example, it comes up in lots of different contexts and platforms.

But also just looking at the level of commitment, how much time is the person spending? Are they economically dependent on the company? Is most or if not all of their compensation coming from the company? Is the work that they do, sort of the heart of what the business does? And what level of control does the company oppose upon the workers? Those are sort of the three main factors that would be looked at as to whether or not someone is an employee or an independent contractor.

Taryn Cannataro: And I guess then related to that, Julie, if there's somebody who is misclassified, what's the risk for misclassification and when does this really practically arise?

Julie Werner: So it comes up in different ways, but generally speaking, so one of the risks is the person should have been an employee and were working hours such that they should be eligible for overtime. It's all the overtime and other costs that Amy mentioned before, as well as potentially benefits, paid leave, sick leave, parental leave. Sometimes it can come up in terms of equity, whether or not they should have received stock options and potentially maybe even the treatment of their stock options. In practice where I've seen it come up in the most unexpected of ways is typically an independent contractor leaves, goes to apply for unemployment and unemployment says, "Who are you? We have no record of you because there's been no payroll withholdings." And then that's where typically the Department of Labor in response to an unemployment application starts looking under the hood and that could lead to an audit.

It also comes up regularly, as I'm sure in the diligence context because a buyer is going to be scrutinizing these things as part of diligence. And looking to see both in terms of the wage and hour, whether or not there's compliance in terms of people being properly treated as exempt or non-exempt, likewise whether or not they were treated as independent contractors and should have been employees.

Taryn Cannataro: So I'm kind of trying to wrap up our discussion. What are some other key developments in the employment law realm at the state level that we should keep an eye on?

Amy Schwind: So one area that's creating a lot of buzz is pay transparency laws. And these are the reason if you've had occasion to look at job advertisement, a job listing, you might have seen depending on what candidates that listing is marketing to and where it is, you might've seen a salary range listed in that job listing and that is because of these laws. So they generally require that employers disclose the compensation rate or range for a position at some point during the pre-employment process, like in the job posting itself, on an applicant's request or at hire. And the general idea is to improve transparency to create a more level playing field for disproportionately impacted groups and improve pay equity. So New York City has one of these laws that became effective on November 1st, 2022. And so covered employers must stay in a job

posting the minimum and maximum annual salary or hourly wage that they in good faith at the time of posting, believe they are willing to pay for the job.

New York State in September will have a similar requirement, and there are also laws cropping up all over the country. Colorado has one, California, Washington and certain other states and there are bills pending in others. Another area that's attracting a lot of attention is artificial intelligence laws. And so at the forefront of this again is New York City, they have a law effective July 5th, 2023, so just in the past few weeks, that limits the ability of employers to use AI in their employment decision tools. So before using a tool to screen a candidate or employee for a covered employment decision, the employer needs to conduct a bias audit on the tool. If more than one year has not passed since the last bias audit, it needs to publicize certain information on its website including a summary of the results. And it needs to give certain notice to candidates and employees about the tool.

At least 16 states including California, have introduced bills or resolutions relating to AI and employment so it really is attracting a lot of attention and a hot topic in the employment realm right now. The EEOC at the federal level has also undertaken an initiative to ensure that AI used in hiring and other employment decisions complies with federal anti-discrimination laws.

Taryn Cannataro: Thank you so much, Amy and Julie for sharing your insight into these important topics. It's important for lawyers to consider these best practices and recent trends in the law when they're seeking to onboard new employees. As you mentioned throughout, the laws regarding employment practices both at the federal and state level are constantly evolving and require a diligent eye to avoid an inadvertent misstep. This episode is intended to be a high-level overview but is by no means an exhaustive discussion of all considerations that may apply to your company and or the hiring process. As always, we encourage you to consult with counsel if you're looking to update your existing hiring practices. Thank you for joining us today, and we look forward to having you back for our next episode of Just Compensation.

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