

# 10 COSTLY (BUT AVOIDABLE) EMPLOYMENT LAW MISTAKES FOR EMERGING COMPANIES

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- 1. Failing to screen prospective employees/consultants.** What restrictions from a prior employer might your applicant be under? Will the applicant be trying to bring trade secrets from his/her prior employer? Under what circumstances did the applicant leave his/her prior employment? Did they take anything proprietary before they left? Remember that this person will do to your company what that person did to the prior employer if that person exits your company.
- 2. Failing to adopt proper background check procedures.** Did you document the rights of applicants and employees, pursuant to the Fair Credit Reporting Act, and various state laws? If not, and you learn something that causes you not to want to hire that person in the background check process, you may not be able to rescind their offer without significant consequences.
- 3. Using bad or outdated agreements.** Did you get your offer letter off the internet, or from a friend/colleague? Don't rely on these as many times they are outdated or unenforceable. At a minimum, every employee should sign an offer letter and some form of proprietary information/confidentiality and inventions agreement prepared by competent counsel. Also, delaying written offer letters or proprietary information agreements for months after the assignment start date may invalidate them, altogether. Likewise, do your agreements have a choice of law/venue selection clause in them? The law is rapidly changing and therefore agreements become outdated quickly, and using someone else's forms may lead to agreements that have provisions that violate state or federal law.
- 4. Using unenforceable noncompetition provisions/agreements.** Everyone knows that in California, "non-competes" are typically not enforceable. But, did you know, that there are exceptions to this rule that can be used to protect your company from the loss of its goodwill or its valuable customers/clients as well as its employees?
- 5. Paying employees in equity instead of through wages/a salary.** It is a common belief that as long as an employee will be granted stock options/restricted stock, the company doesn't have to pay people wages in dollars. This is INCORRECT! Moreover, asking individuals, including founders/officers to "defer" wages is illegal and also raises IRS/tax issues.

- 6. Hiring individuals to work as “consultants” or independent contractors?** One of the big pushes of the IRS, as well as several state based agencies, is to crack down on employers (both small and large) who misclassify employees as consultants or independent contractors. Except in very limited circumstances, those “consultants” are likely your “employees” and they must be paid at least minimum wage and are subject to payroll taxes, among other things. Don’t wait until the IRS or the state seeks to audit certain jobs, seeking back taxes, among other penalties.
- 7. Classifying individuals as “exempt” from overtime.** There are both federal and state law considerations, and the rules are tricky to apply. Though you hire someone as a “engineer” or “software engineer,” and they have a degree, it does not mean they are “exempt” from overtime. And, the penalties can be huge, and put your company out of business very quickly, particularly when everyone is working nights and weekends to make the enterprise successful. Back wage obligations can go back 4 years, for each individual misclassified as “exempt.” Also, there are attorneys’ fees that you’ll have to pay out to the employees’ attorneys, and those can be a crushing blow beyond simply the wages due.
- 8. Non-compliant commission and bonus plans.** Did you know that commissions and bonuses are deemed to be “wages,” and, therefore, state and federal law regulate whether the terms are fair or proper? There are complex rules that govern the enforceability of commission and bonus plans. If you don’t get it right, you could be owing your employees thousands of dollars and attorneys’ fees. For example, plans that require an employee to be employed in order to get paid his/her commissions may be illegal, and may subject the company to wage/hour litigation, unless the plan/agreement contains certain acknowledgements.
- 9. Failing to identify and then protecting the Company’s trade secrets.** What are the Company’s trade secrets? Where are they stored? Who has access to them? Is the facility secure? Does the Company have properly worded proprietary information/confidentiality agreements? Depending on how the Company answers these questions will be critical to whether the courts will grant the Company’s confidential information trade secret status.
- 10. Not paying employees timely during employment and/or upon termination.** Many state laws, including California, mandate that every employee adopt specific dates upon which wages will be paid. Likewise, upon termination, state law requires payment of wages and any accrued but unused paid time off/vacation within a very specific amount of time. Failing to comply with these rules, subject the Company penalties and attorneys’ fees. Again, the wages and penalties can be very significant.