

EMPLOYER LIABILITY, CAN YOU LIMIT YOUR EXPOSURE?

"FROM EVALUATIONS TO POLICY LANGUAGE"

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I. INTRODUCTION

One of the most common situations that create employment litigation is the termination of an employee. When the employee relationship is severed, employee loyalty also is severed. The employee in question has lost his or her livelihood, so emotions and economic stakes are high. A great deal of emotion may result from the termination, not only because the employee was discharged but because of the employee's perception of the manner in which s/he was treated before the discharge, either during an investigation of an alleged rule or policy violation or during a performance evaluation.

With the steady erosion of the employment-at-will doctrine, which traditionally defined the employee-employer relationship, employers must utilize every opportunity to limit its liability. Two of the most important ways employers can limit their liability is through the careful drafting and implementation of employment policies and equitable treatment of all employees. This paper will discuss the employment-at-will doctrine, its steady erosion, performance evaluations and language that the employer can insert in personnel policies in an attempt to limit its liability.

According to the Bureau of Labor Statistics, the number of employment related lawsuits filed in federal court since 1973 has increased 2,166%. While this exponential growth seems to have peaked, approximately 1,000 new employment related cases are being filed each month. Many of these cases allege discrimination based on an employer's inconsistent application of its personnel policies. Further, in many of these cases, the alleged inconsistent application of personnel policies stemmed from the employer's failure to reduce its policies to writing.

II. EMPLOYMENT-AT-WILL

A. History of Doctrine

The doctrine of employment-at-will provides that when a private sector employer hires an employee to work for an indefinite period of time, and the parties have not otherwise limited their rights to terminate the employment relationship, either party -- the employer or the employee -- is free at any time to sever the employment relationship for any reason. In other words, absent an employment contract for a definite duration, either the employer or employee can terminate the employment relationship at any time for any reason.

The at-will doctrine is British in origin and was adopted in the United States during the ascendancy of *laissez-faire* economics in the early twentieth century. The doctrine received support from the United States Supreme Court in Adair vs. United States, 208 U.S. 161 (1908). In Adair, the Court invalidated state and federal legislation prohibiting employers from discharging employees for joining unions, ruling that denying the employer the discretion to discharge employees "without giving any reason for so doing" would constitute a deprivation of property without due process in violation of the Fifth Amendment of the United States Constitution. 208 U.S. at 176.

B. Limitations on Doctrine

This doctrine continued unimpeded for decades. In 1937, however, the United States Supreme Court overruled Adair and held that the Wagner Act prohibited employers from discharging employees because of their union activity. N.L.R.B. vs. Jones and Laughlin Steel Corporation, 301 U.S. 1 (1937). With the constitutional basis for the at-will doctrine removed, federal and state legislatures began enacting various statutes, which restricted an employer's, right to lawfully discharge an at-will employee.

Federal statutes that limit the doctrine include the Fair Labor Standards Act, Equal Pay Act, National Labor Relations Act, Age Discrimination In Employment Act, Rehabilitation Act of 1973, Occupational Safety and Health Act, Title VII of the Civil Rights Act of 1964, as amended, the Civil Rights Act of 1991, Americans With Disabilities Act, and Family and Medical Leave Act.

On a state level, North Carolina has enacted the Retaliatory Employment Discrimination Act which prohibits, among other things, employers from discharging an employee because he or she filed a claim for workers' compensation benefits; participated in an Employment Security Commission hearing; participated in an occupational safety and health investigation; filed a complaint pursuant to the North Carolina Wage Payment Laws, or possesses a Sickle Cell or Hemoglobin C Trait. Also, North Carolina law prohibits the termination of an employee because of membership or nonmembership in a labor union or because of a handicapping condition.

C. Status of Doctrine in North Carolina

Since 1943, the courts of North Carolina have recognized the employment at-will doctrine. Malever v. Kay Jewelry Company, 223 N.C. 148 (1943). For the most part, North Carolina still adheres to the doctrine. See, Still v. Lance, 279 N.C. 254 (1971). ("Agreements that are indefinite in duration, nothing else appearing, are terminable at the will of either party irrespective of the quality of performance by the other party. "); See also, Gravitte v. Mitsubishi Semiconductor America, Inc., 109 N.C. App. 466, rev. denied, 334 N.C. 163 (1993).

While the doctrine is "alive and kicking", North Carolina courts have carved out some limited exceptions to the general rule. Absent such special circumstances, however, employers still have the right to terminate employees at any time and for any reason with or without any notification. Tompkins v. Allen, 107 N.C. App. 620 (1992).

In 1989, the North Carolina Supreme Court issued Coman v. Thomas Manufacturing Company, 325 N.C. 172 (1989), thus creating an exception to the employment-at-will doctrine for terminations that are contrary to the public policy of the State. The court did not clearly define what actions constitute a violation of public policy. It, however, did define "public policy", as "the principle of law which holds that no citizen can lawfully do that which has the tendency to be injurious to the public or against the public good." 325 N.C. at 175 n.2.

Thus, a discharge is actionable if an employee is terminated for reasons that contravene public policy, as expressed in the North Carolina statutes. See e.g., Oakdale Knitting Company, 331 N.C. 348 (1992) ("Discharge of an employee who refused to work for wages below the statutory minimum violated North Carolina public policy"); Lenzer v Flaherty, 106 N.C. App. 496 (1992) (Physician's assistant survived summary judgment by alleging discharge for making reports of abuse and exercising free speech rights by questioning status of investigation of patient abuse.); Cf., Hogan v. Forsyth Country Club Company, 79 N.C. App. 483 (1986) (Plaintiff failed to state a claim for wrongful discharge when she alleged she was discharged leaving work for a doctor's appointment despite her supervisor's denial of her request.)

In addition to the public policy exception to the at-will employment doctrine, North Carolina courts, also, have expressed a willingness to recognize exceptions when the employee provides additional consideration for an offer of employment or based on language in an employee handbook. See, Liggett Group, Inc. v. Sunas, 113 N.C. App. 19 (1993).

Of specific note is a case recently decided by the North Carolina Court of Appeals. In Deerman v. Beverly California Corporation, _ N.C.App. _ (1999), the Court reversed a trial court's dismissal of the plaintiff's complaint alleging wrongful discharge. Specifically, the Court held the plaintiff did in fact state a claim for wrongful discharge when she alleged she was terminated for suggesting to a patient's family that they consider changing physicians. In so deciding, the Court of Appeals expanded the at-will exceptions because the plaintiff in complaining about the physician in question did not do so to comply with a specific provision of North Carolina law. Instead, she did so to comply with a provision of the North Carolina Nursing Practices Act which requires that nurses "counsel" patients about treatment.

D. Implied Covenant of Good Faith and Fair Dealing

Courts outside North Carolina generally characterize the bad faith exception as an "implied covenant of good faith and fair dealing" in the employment contract. To date, the North Carolina courts have not recognized a "bad faith" exception to the at-will employment doctrine.

For example, in McLaughlin v. Barclays American, 95 N.C. App. 301 (1989), the Court found the plaintiff failed to state a claim for bad faith discharge by alleging he was discharged after engaging in a fight with a co-worker about which he had previously complained to his supervisor. See also, Salt v. Applied Analytical, Inc., 104 N.C. App. 652 (1991) (Allegations that employer disregarded its promise of permanent employment and gave false reasons for the discharge of plaintiff did not state a claim for breach of the implied covenant of good faith and fair dealing.)

While the state courts have not recognized the bad faith exception to the employment at-will doctrine, at least one federal court in North Carolina has recognized the exception. See, Iturbe v. Wandel & Goltermann Technologies, Inc., 774 F. Supp. 959 (M. D. N. C. 199 1) (Failure of employer to follow termination procedures in employee handbook raised issue of bad faith discharge); Cf., English v. General Electric Company, 765 F. Supp. 293 (E.D.N.C. 1991) (Allegation that plaintiff was discharged for reporting safety violations at nuclear facilities, did not set claim for bad faith discharge.)

III. PERFORMANCE EVALUATIONS

The primary purpose of an employee appraisal is to improve the performance of the employee by providing prompt, constructive feedback on how well the employee has met the employer's expectations. Moreover, performance evaluations are generally accepted by management as both necessary and beneficial to the organization. However, the difficult aspect of performance evaluations is communicating with an employee about deficiencies in performance while at the same time motivating him to improve. Unfortunately, few managers can achieve this goal successfully because a properly performed evaluation takes precious time and energy away from the already busy schedules of the manager and because many managers can not stomach the "confrontation" into which many performance evaluations devolve. Therefore, poor performance oftentimes goes unaddressed until it is time to terminate an employee. If an employee has not been informed of his performance deficiencies prior to termination, he is apt to believe his employer is treating him unfairly, and performance is not the real reason for termination. Obviously, this type of reasoning increases employers' chances of being sued.

To avoid the latter and the inherent conflicts into, which many evaluation programs devolve, employers should consider the following:

- 1) Formalize the evaluation system and reduce it to writing;
- 2) Provide specific training about your system to managers/supervisors;
- 3) Use simple, concise evaluation forms;
- 4) Clearly identify performance expectations;
- 5) Allow for employee input in establishing performance expectations;
- 6) Actively involve employee in the evaluation process;
- 7) Have evaluations performed by manager who is familiar with job duties and actual performance of employee evaluated;
- 8) Clearly communicate evaluation results to employees;
- 9) Evaluate employees fairly, stressing weaknesses and strengths;
- 10) Establish reasonable goals for improvement
- 11) Require employee to read and acknowledge in writing an evaluation with an opportunity to comment in writing about the evaluation;
- 12) Allow for appeal of evaluation to higher-level management;
- 13) Unless performance requires immediate response, perform on a regular basis (i.e. every 6 months);
- 14) If performance requires immediate response, perform ASAP; and
- 15) Reward managers whose employees improve and develop within evaluation system (i.e. higher achievement of goals and less turnover)

IV. POLICY LANGUAGE

With the continual erosion of the employment at-will doctrine, employers periodically should scrutinize their personnel procedures and policies. If a review is undertaken, employers should ask the following questions: Are human resources' policies and procedures reduced to writing? How are the policies enforced? Are the policies consistently enforced? Do the policies, if written, contain liability-limiting language?

When personnel policies are unwritten, they are often applied inconsistently, resulting in poor employee morale and increased employment litigation. However, when they are written and distributed to employees, the policies and procedures can create the best possible defense to charges of employment discrimination or wrongful and bad faith terminations. Further, written policies allow employers to state their philosophy and mission statement; create basis for consistent treatment of employees; define standards of conduct; can positively affect employee morale; and, most importantly, reduce misunderstandings between management and employees.

A. Employment Applications

If used properly, employment applications are the most useful tools in the pre-employment process. They elicit important information from which an employer, hopefully, can make preliminary decisions about an applicants' qualifications for a particular employment position. However, asking the wrong question on an application could create legal liability (i.e. evidence of a discriminatory practice). To avoid potential liability, employers should develop applications that only request job-related information. Specifically, applications should:

- 1) Comply with applicable federal and state discrimination laws;
- 2) Absent a bona fide occupational qualification, not inquire about an applicant's age, gender, race, color, etc.;
- 3) Be completed by all applicants (a resume is not sufficient because it is regarded as a summary of job experience);
- 4) Include language indicating the application does not insure employment or constitute an offer of employment;
- 5) Include at-will employment language;
- 6) Require applicant to confirm information stated on application is true and accurate ("Provision of false information may result in immediate discharge); and
- 7) Indicate if employer will require a drug test.

B. Releases

Whether an employer is faced with a reduction in force, mass retirement, or settlement of a claim of employment discrimination, two important questions almost always arise. First, should the employer require execution of a release of all potential employment related claims ? Second, does presenting a lengthy legal document encourage the departing employee to retain an attorney for advice and counsel ?

Unfortunately, these issues do not lend to standard, across-the-board responses. Circumstances and facts of each situation are different, and employers should address each case individually. When faced with these questions, however, employers should consider the employment position of the person(s) in question; the amount of money or severance to be paid; the attitude and expected reaction of the employee(s); whether the employee(s) had access to sensitive company information; and whether the employee(s) has retained an attorney.

When a release is deemed appropriate, employers should include the following information in the release:

- 1) An agreement written in an understandable language;
- 2) Specific reference to rights or claims released (N.C. Handicapped Worker's Protection Act, ADEA, etc.);
- 3) Statement that employee is not waiving any claims, which arise after execution of the release;
- 4) Reference to specific cases or charges of discrimination covered by the release;
- 5) Where appropriate, that the executed release is a compromise of all possible claims;
- 6) Non-admission of liability clause;
- 7) Confidentiality clause concerning the terms of the release;
- 8) Tax consequences of the release;
- 9) Recommend consultation with an attorney prior to execution;
- 10) Time period for review and execution of the agreement (i.e. 21 days);
- 11) Time period for revocation of the agreement after execution (i.e., 7 days);
- 12) Severability clause;
- 13) State law under which the agreement will be interpreted (i.e., North Carolina);and
- 14) Integration clause.

C. Restrictive Covenants

North Carolina restrictive covenant law has become a confusing tangle of conflicting judicial decisions, and, sometimes, inflexible and impractical legal standards. Many employers have discovered that North Carolina restricted covenant law has unduly favored the interests of employees and hindered the ability of North Carolina businesses to protect their personnel and customer bases.

Generally, there are three types of restricted covenants. The first type is referred to as a "non-competition" covenant. This restricted covenant is the broadest of the three types, and typically prohibits the party making the covenant from engaging in a business activity in direct competition with the business activities of the party with whom the covenant is entered. The second type of restricted covenant is a customer non-solicitation covenant which generally prohibits a former employee from soliciting business from the former employer's customers and prospective customers. The third type of restricted covenant is a personnel nonsolicitation covenant. This type of covenant, which is sometimes known as an "anti-piracy" covenant, is used to restrict a former employee from luring away personnel of the former employer to a competing business. Woolcott, A Turning Point for the Enforceability of Restrictive Covenants, Georgia State Bar Journal, Vol. 29, No. 3 (February 1993).

The three forms of restricted covenants discussed above are often grouped into two broad classes --- "employment-related" restricted covenants and "sale of business related" restricted covenants. This section only discusses the employment-related restricted covenants. Much of the litigation in this area centers on the enforceability of post-termination, employment-related non-compete and customer non-solicitation covenants.

North Carolina General Statute 75-1, states that contracts and restraints of trade are illegal in North Carolina. This statute seemingly prohibits restrictive covenants because the underlying objective of these agreements is to stifle competition. However, courts in North Carolina routinely enforce employment-related restrictive covenants, if they meet the following requirements:

1. Are in writing;
2. Entered into at the time and as a part of a contract of employment;
3. Based on valuable consideration;
4. Reasonable both as to time and geographic area embraced in the restriction;
5. Fair to the parties to the agreement; and
6. Do not violate public policy.

See e.g. , Amdar, Inc. v. Satterwhite, 37 N.C. App. 410 (1978).

Before a court will enforce a covenant not to compete in an employment contract, it usually must find that the employee, as a result of his employment, had intimate knowledge of the nature and character for the employer's business that is not otherwise generally available to the public. United Laboratories, Inc. v. Kuykendall, 87 N.C. App. 296 (1987). In Kuykendall, the court held that a covenant not to compete in a 1982 sales representative agreement was not enforceable under North Carolina law because it did not protect a legitimate business interest of the employer. The employer offered no evidence the ex-employee received any information about the plaintiff's business, other than pricing information, that also was not available to the general public. Further, the defendant's knowledge about buying habits and special needs of the plaintiff's customers was acquired through the efforts of the defendant, not by any specific effort of the employer. Finding the covenant was not necessary to protect the interest of United Laboratories, the Court refused to enforce it.

Additionally, if an employer attempts to enforce a covenant not to compete, it must establish that the covenant in question does not violate public policy. For example, in Nalle Clinic Company v. Parker, 101 N.C. App. 341 (1991), the court refused to enforce the covenant not to compete against defendant as a matter of law. In the case, the Court found the covenant violated public policy because it prohibited defendant from practicing medicine in Mecklenburg County for two years after his employment with plaintiff ended. Defendant was the only full-time pediatric endocrinologist in Mecklenburg County, and the Court reasoned to prohibit him from practicing would have created an excessive work load for the only part-time pediatric endocrinologist in the

county, and would likely result in undesirable and possible critical delays in patient care and treatment. 101 N.C. App. at 344; See also, 19 N.C. Index 4th, Labor and Employment § 830.

On the issue of consideration, enforceability of a covenant depends on when an employer and employee entered into the agreement in question. Assuming that an agreement meets all of the other requirements, North Carolina courts, generally, find that the job itself is adequate consideration for an agreement entered pre-employment. Brooks Distributing Company v. Pugh, 91 N.C. App. 715, rev'd on other grounds, 324 N.C. 326 (1988). However, if a covenant is imposed on an employee after beginning work, the employer must provide additional consideration other than continued employment, such as a change in duties, a promotion or a pay increase. James C. Greene Company v. Arnold, 266 N.C. 85 (1965).

Finally, the scope of a restrictive covenant in an employment contract should be no broader in scope than is reasonably necessary for the protection of the employer's business. North Carolina courts consider the following factors in determining whether time/territory restrictions are reasonable:

1. Geographic area or scope of the restriction;
2. Geographic area assigned to employee;
3. Geographic area in which employee actually worked;
4. Geographic area in which employee operated;
5. Nature of business involved;
6. Nature of employee's duty and his knowledge of employer's business operations; and
7. Whether time period involved precludes employee in question from earning a living.

See, Electrical South, Inc. v. Lewis, 96 N.C. App. 160 (1989) (Non-compete unenforceable because covenant stated employee could not "own, manage, operate, participate in, or be connected in any manner with the ownership, management, operation, or control of any concern which manufactures or designs industrial solid state electronic equipment or repairs or services industrial solid state industrial equipment which competes directly or indirectly with a company of such endeavor of 200 miles of Greensboro"); Manpower of Guilford County, Inc. v. Hedgecock, 42 N.C. App. 515 (1979) (Time limitation of one-year in non-compete was reasonable.)

If an employer decides to require non-compete agreements as a condition of employment, the document should comply with all of the above listed requirements. Additionally, the agreements should:

- 1) State with specificity the acts the employee is precluded from performing during and subsequent to employment (i.e., sales representative or consultant, solicitation of customers or employees);
- 2) Require employee to acknowledge and agree that territorial and time limitations as well as other restrictions set forth in the agreement are reasonable and necessary to protect the legitimate interest of the employer. **(Of course, a court will look beyond the language of the agreement; however, a court may give greater deference to such language, if the employee reads and signs the agreement);**
- 3) Indicate time limitations stated in the agreement do not include any period of time during which the employee is in violation of any provision of the agreement or for any period of time required for litigation to enforce any provision of the non-compete agreement; and
- 4) **State the non-compete is assignable if employer subsequently sells or merges its business** (Reynolds Company v. Hardee, 2:96cv327 (M.D.N.C. 7/11/96) (salesman's non-compete no longer enforceable where employer sold business, and agreement did not state it was assignable).

D. Employee Handbooks

As stated above, the main objective of an employee handbook is to communicate basic rules and policies of a company. Many employers also use employee handbooks and policy manuals to state company philosophies and establish objectives for future development.

Further, many employers, through handbooks differentiate between probationary and non-probationary employees. By so differentiating, someone unfamiliar with this area of the law might assume the employer in question has expressed an intent to create a "permanent" employment category; whereby, the non-probationary employees are terminable only for cause. This assumption might be especially true when the employer consistently follows the just cause standard for employee discipline and termination.

However, the North Carolina Court of Appeals in a case of first impression held that company policies in handbooks and personnel manuals are unilateral guidelines that the employer can follow, disregard or revise at the employer's discretion. Williams v. Biscuitville, 40 N.C. App. 405 (1979). In contrast to the Biscuitville case, the North Carolina Court of Appeals held in Trought v. Richardson, 78 N.C. App. 758 (1986), if policies containing a just-cause standard are expressly incorporated in an employee's contract of employment, the terms are enforceable.

Subsequent to the Biscuitville decision, North Carolina courts have consistently found that a unilaterally promulgated employee handbook or personnel manual does not form an employment contract. See Harris v. Duke Power Company, 319 N.C. 627 (1987) (The court rejected employee's claim of wrongful discharge based on a handbook provision because the provision did not expressly include a just cause standard); see also, Rucker v. First Union National Bank, 98 N.C. App. 100, cert denied, 326 N.C. App. 801, (1990); Salt v. Applied Analytical, Inc., 104 N.C. App. 652 (1991); Ligge Group, Inc. v. Sunas, 113 N.C. App. 19 (1993) (Court refused to incorporate employee handbook into an existing employment contract because the contract, itself, did not specifically incorporate the handbook).

Even though the cases cited above are contrary to the general legal principles applicable to unilateral contracts, employers should carefully draft handbook language to avoid potential legal attack and further erosion of the employment at-will doctrine. The best way to achieve these objectives are to include clear language indicating the handbook is merely a guide to policies, benefits and general information, and employees should not construe it as creating a contract for employment.

Employee handbooks should include the following information:

1. Employment at-will language (**i.e., This handbook is intended solely as a guide to XYZs policies, procedures and benefits. The information contained herein does not constitute a contract of employment, expressed or implied, nor does it alter your at-will employment status whereby, the company can discharge you or you can resign for any reason or no reason without notice.**);
2. Statement on equal employment opportunity;
3. Statement on employment harassment, including separate language concerning harassment;
4. Workers' compensation;
5. Employee Benefits (include language that employees should refer to Plan Summaries regarding specific employee benefits);
6. Attendance policies;
7. Work rules;
8. Disciplinary procedures;
9. Indicate policies contained in the handbook are subject to discontinuation or revision at any time, with or without notice to employees;
10. Safety and health rules, applicable to specific industries;
11. Rules concerning personal appearance and dress;
12. Require employees maintain confidentiality of company information;
13. Statement about company's compliance with applicable federal laws (i.e., ADA and FMLA); and
14. Summary of situations under which an employee may take a leave of absence (i.e., military leave and North Carolina parental leave).

Even though employee handbooks do not create binding unilateral contracts of employment, employers should encourage employees to read the employee handbook and applicable personnel policies. Additionally, employers should require that employees acknowledge in writing that they have received a handbook, including any subsequent revisions, and have read and will comply with the contents therein.

V. CONCLUSION

As employment law continues to evolve, or devolve depending on your perspective, employers also must be prepared to change. The best way to change with the least amount of pain (i.e.-lawsuits) is to review personnel policies regularly. Failure to do so inevitably will result in increased attorneys' fees, litigation, and possibly significant jury verdicts. Therefore, the ultimate question is not do your personnel policies contain language that limits liability, but can you afford policies that do not?