Top Five Employment Law Pitfalls Entrepreneurs Should Avoid

BY SCOTT S. HOFFMANN, ESQ.

The entrepreneurial spirit is as much a part of the fabric of America as apple pie. Entrepreneurs dream big, work hard and invest in their burgeoning businesses. However, while their intentions may be noble and ideas unparalleled, many entrepreneurs fail to properly attend to what is arguably their most valuable asset.

Human capital is essential for any new business, whether in the form of partners, employees, freelancers, consultants or someone else; human capital often dictates the success or failure of any business. While welcoming like-minded, passionate people into an organization can be a source of immense pride for entrepreneurs, it also presents employment law challenges that, if ignored, can prove detrimental to the business. However, entrepreneurs who heed these five common employment law pitfalls may well attain their goal of turning their business into the next Fortune 500 company.

The Classification of Workers

One of the biggest mistakes that entrepreneurs make is improperly classifying their workers. Where capital is limited, entrepreneurs don't have the funds to hire what they classify as a traditional employee. They will often hire what they classify as consultants, freelancers or even interns in order to help execute their business plans. But how they classify these workers can have serious consequences from an employment law perspective.

First, the determination of who is an independent contractor and who is an employee is dictated not only by the two parties, but also by federal and state wage and hour laws that rely on multifactor tests. An entrepreneur labeling a worker as a consultant does not, by itself, determine the classification of that worker. One must look to the degree of control the company has over the worker, whether the worker provides similar services to other companies and holds himself/herself out to the public for such engagements, and the permanence of the relationship, as well as other factors. True independent contractors are not subject to wage and hour laws including overtime and minimum wage requirements, nor are they subject to payroll taxes.

Not surprisingly, then, the consequences, to an entrepreneur, of mischaracterizing an employee as an independent contractor can be significant, if not crippling. These include the payment of wages (minimum wage and overtime) that the employee would have been entitled to had he or she been classified correctly. Payroll tax liability can also be incurred as a result of the misclassification; that can carry with it interest and penalties at best, and criminal penalties at worst.

One helpful way to ensure that workers are correctly classified is to create an accurate job description. A good job description is valuable on multiple levels: first, it creates on outline of what the job is and what the job is not; second, it can help the employer (and his or her counsel) perform a comparative analysis of the position; next, it can be used to differentiate and evaluate candidates on job-related criteria; and, lastly, it can be used as a benchmark to evaluate a worker's performance as appropriate. Creating accurate job descriptions also saves time and money when it comes time to conducting a job classification audit.

Wage and Hour Laws Paying Employees

After classifying a worker as an employee, many entrepreneurs find that they do not have the necessary cash flow to pay an employee a standard hourly wage or salary and choose to offer other methods of compensation, such as equity, either in lieu of or in addition to an employee's wages. This raises several concerns.

First, as a general matter, stock and options in a company do not properly account for payment of minimum wage calculations. Minimum wage in Nevada is $7.25 per hour with healthcare benefits and $8.25 per hour without. NAC 608.100 et seq. Offering a sub-minimum wage hourly rate that is supplemented by equity is a violation of wage and hour laws. So, it is essential that workers are classified and paid properly.

Overtime and the failure to pay overtime is another minefield for entrepreneurs. Wage and hour laws distinguish between nonexempt and exempt employees. Exempt employees include those who are ineligible for overtime by making at least $455 per week as determined by the salary basis test and those whose job duties fall into one of several exemption categories, including executives, administrative and computer professionals — the analysis of which is anything but straightforward. Any employee who does not meet these criteria, possibly including CEOs and founders, is eligible for and must be paid overtime for time worked.

Differences in state law further complicate matters. For example, overtime in Nevada is calculated differently than overtime calculated under federal law. In Nevada, if an employee makes less than one-and-a-half times the minimum wage per hour ($12.38 without medical benefits or $10.88 with medical benefits), the employee must be paid overtime for any time worked over eight hours in a 24-hour period. *See* NRS 608.018. Those employees who make more than the above-referenced rate per hour only need to be paid overtime for time worked over 40 hours in a week (with the exception of those employees who agree to work four 10-hour shifts.) Id.

While a common practice, it's important to keep in mind that providing equity does not alleviate an employer from the minimum wage laws, nor the obligation to pay overtime to nonexempt employees. Just like misclassifying employees as independent contractors, the financial ramifications of misclassifying employees as exempt when they are truly nonexempt can be staggering and can undermine, if not cripple, an otherwise sound business plan.

Invalid or Ineffective Restrictive Covenants

Many entrepreneurs strive to safeguard their companies' treasures, secrets and intellectual property through tools such as confidentiality agreements, non-competes, non-solicitations and non-disclosure agreements (collectively referred to as restrictive covenants). A non-compete provides that an employee will not work for a competitor for a certain period of time after his or her employment ends. A non-solicitation agreement can be directed at either employees or customers; in the case of the former, a non-solicitation agreement prevents a former employee from targeting the company's customers on behalf of his or her new employer for a certain period of time. In the case of the latter, a non-solicitation prevents a company from poaching another's current employees. Confidentiality agreements and non-disclosure agreements protect certain information that is not publicly known.

However, no matter what the restrictive covenant, unless the entrepreneur understands its nature and purpose and is willing to commit time and money to its enforcement, restrictive covenants can often prove more of a hindrance than a benefit. Some questions all entrepreneurs should ask themselves before preparing restrictive covenants: are my restrictive covenants really doing what I want them to do?; are they a fit with the company's overall purpose and goals?; are they truly reasonable?; and are they enforceable?

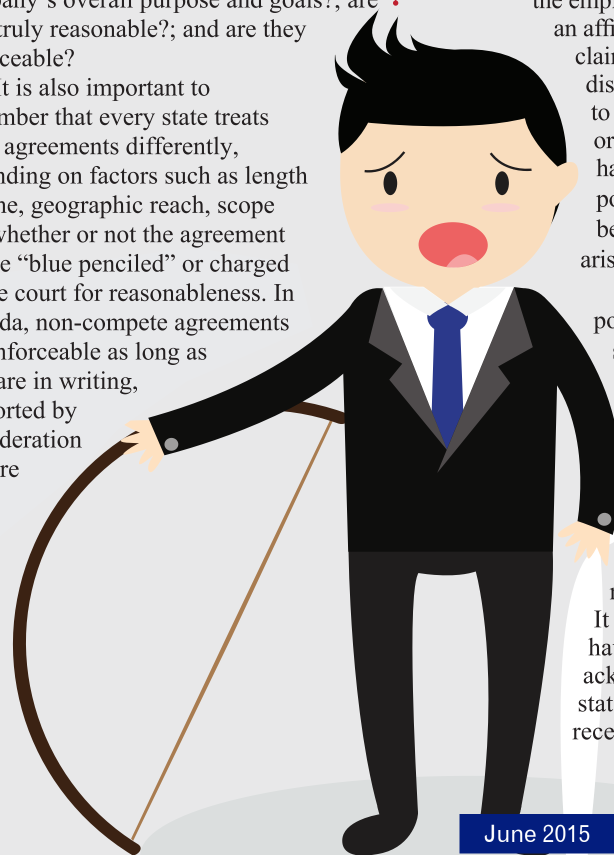
It is also important to remember that every state treats these agreements differently, depending on factors such as length of time, geographic reach, scope and whether or not the agreement can be "blue penciled" or charged by the court for reasonableness. In Nevada, non-compete agreements are enforceable as long as they are in writing, supported by consideration and are reasonable as to scope and duration. *See* NRS 613.200(4). It is essential that restrictive covenants are properly drafted with counsel, that they are tailored to the individual to whom they are proffered (as one size does not fit all) and that they take into account where the company may seek to enforce those agreements.

Workplace Policies: Start with Two

Most entrepreneurs are not interested in creating extensive employment policies when they first form their businesses. While it is understandable that creating a comprehensive 50-page employee handbook is not on the top of the list of priorities, and indeed may not be practical given how few employees an entrepreneur might have at the beginning stage of his/her business, all entrepreneurs, no matter the size of their businesses, should at least have two policies in place: a sexual harassment policy and an equal employment opportunity policy.

Under both federal and Nevada law, an employer can demonstrate that having a sexual harassment policy with a complaint procedure (so employees can let the company know if harassment or discrimination is occurring in the workplace), is a defense to a sexual harassment or other discrimination claim. *See Dennis v. Nevada*, 282 F. Supp.2d 1177 (2003). If an employee files suit for sexual harassment or other discriminatory conduct but never complained to the employer first, the employer can use that fact as an affirmative defense to the claim. *Id*. In Nevada, anti-discrimination laws apply to employers who have 15 or more employees. Thus having a sexual harassment policy is a tremendous benefit should litigation arise. See NRS 613.310.

A sexual harassment policy is relatively simple to establish, and it may be posted conspicuously in an employment manual, on the company's intranet site or provided separately as part of new hire paperwork. It is also beneficial to have employees sign an acknowledgement form stating that they have received and understand the



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company's equal employment opportunity policy and its complaint procedure. Maintaining such internal controls will also put the entrepreneur in good stead with strategic partners and customers.

When Employees Leave Your Company

Entrepreneurs are often focused on the big picture of their companies. They do not look into the minutiae of their businesses, such as what happens when an employee leaves. Unfortunately, it is inevitable that some employment relationships will just not work out. When an employee leaves, either voluntarily or involuntarily, entrepreneurs should focus on protecting assets. If an employee is being let go, entrepreneurs may wish to consider a separation agreement, through which an employee waives his/her right to bring a lawsuit in exchange for an amount of money or some other consideration. When terminating employees, the last thing most employers want to do is give them more compensation, but entering into such an agreement could be significantly less expensive than a lawsuit and could constitute a good long term investment.

Another important factor entrepreneurs should consider when an employee leaves the company is physical and intellectual property. For example, if the employee has access to or manages the company's website and/or social media sites, it will be important to ensure that all passwords are returned or changed. Many lawsuits have been filed recently asserting that a company's social media accounts belong to the employees who write for them, and that the followers or connections also belong to those employees.

Similarly, if an employee was given a phone, tablet or laptop, it will be imperative for the employee to return those devices. If the company allows an employee to use his or her own phone, it is strongly advisable to make certain that work email has been deleted from the worker's personal phone.

Remember all of those restrictive covenants the employees agreed to? It is imperative to remind them, on their way out, that these obligations continue post-employment. Reminder letters should be sent as needed. In the event a former employee begins to engage in conduct that potentially violates his/her post-employment obligations, entrepreneurs can consider sending cease-and-desist correspondence to both the employee and, when applicable, his/her new employer.

Employment issues are usually the furthest thing from an entrepreneur's mind when starting a business. However, avoiding these five common pitfalls may make the difference between a failed or successful business! NL

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