SEYFARTH SHAW

Drafting Employment Contracts: Getting the Foundations Right

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1 Introduction

The employment contract is an important tool for employers. Not only is it your 'introduction' to prospective and new employees, but your contracts of employment:

- give the employer the opportunity to set out, clearly, all of the employee's obligations to the employer; and
- can help set the tone for how employers will manage the employment relationship with employees moving forward.

Some employers take a lackadaisical approach by seeing contracts as just an administrative part of the on-boarding process, while other employers treat employment contracts as "welcome letters" without keeping the central purpose of the an employment contract front and centre in their minds.

Employment contracts should be seen as fundamental tools for employers to get the foundations right. In our experience, there are three central themes that need to be kept in mind in order to get the foundations right in an employment contract - clarity, flexibility and protection. These themes are essentially the "lenses" that should be applied to employment contracts to ensure that they are fit for purpose:

(a) **Clarity**: employment contracts are an employer's opportunity to clearly set out the obligations of and expectations it has for employees. Clarity enables an employer to later rely on and enforce the terms of the contract should a dispute arise, and can also prevent misunderstandings in any case.

(b) **Flexibility**: while it can be tempting to precisely set out *everything* the employer expects of the employee, employment contracts are also an opportunity to provide flexibility to an employer, including the ability to modify or change operations without the need to renegotiate the contract, or unintentionally triggering a breach of contract or redundancy situation.

(c) **Protection**: employees are often given access to a lot of sensitive information during the course of employment. Employment contracts are an opportunity for the employer to protect its commercial interests both during and after the employment relationship through the inclusion of clauses relating to intellectual property, confidentiality and post-employment restraints.

Applying these lenses means that, more often than not, a contract needs to be tailored in many ways to the particular employee concerned - in other words, there is no "catch-all" approach. The contractual arrangements will depend on the employer, employee and the work to be done. There are a variety of ways in which employers can set out the commitments they expect from employees and the needs of each company will inform the most suitable approach.

[1] With thanks to Rebecca Brediceanu for her assistance.

This paper considers the ways in which those foundation principles can be utilised to enable employers to make their employment contracts (and their employees!) work best for them.

2 The benefits of a written employment contract

Every employee has an employment contract - whether it is in writing or not. But it is, of course, better if it is written down! We have advised many employers who find themselves in difficult situations where there is no written agreement with an employee, or the employee asserts that a particular term was agreed before they started employment. In the absence of a written contract, there is a high degree of uncertainty about many aspects of the relationship. One particularly important example is in relation to notice periods - where an employer does not have a written agreement with an employee regarding the employee's notice period, an employee may be able to argue that they should receive '*reasonable notice*' - which means that the court will look at all the circumstances to determine the notice period, such as the employee's service and seniority.

Written contracts can also ensure that employers have rights which they might not otherwise have. One recent example was the case of *Harrison v FLSmidth*[2]. In that case, the Fair Work Commission (**FWC**) considered whether the demotion of an employee (coupled with a 9% pay cut) was in fact a dismissal. The employer argued that it was an unwritten term of the employee's employment that he could be demoted by unilateral decision of the employer - and therefore not a dismissal. The Commission was not prepared to find that there was an implied term to that effect.

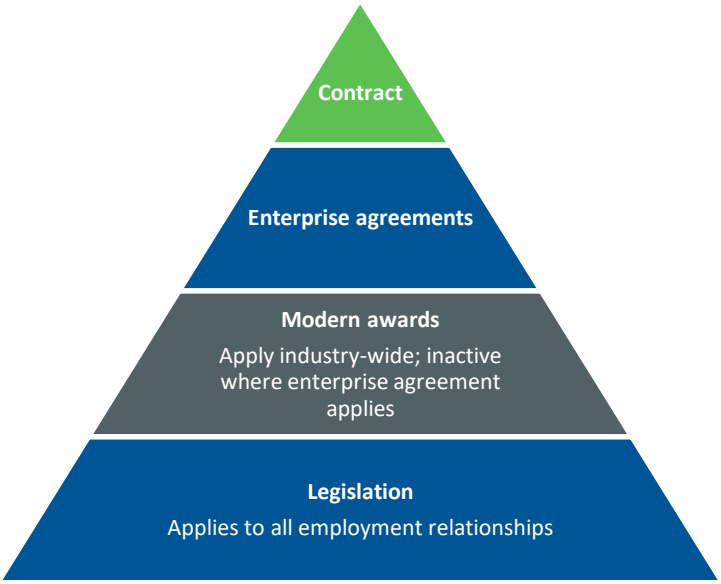
3 Getting the baseline right

3.1 *Sources of employment rights and entitlements*

In preparing employment contracts, Australian employers need to keep in mind the minimum or 'baseline' employment entitlements for employees.

Employment entitlements in Australia are regulated by a variety of overlapping rights and benefits (as depicted in Figure 1), with the minimum entitlements depicted in ascending order (i.e. minimum entitlements for employees are contained in legislation, then modern awards, etc.). Australian employers are covered by a framework of Federal laws. This system includes:

(a) **Legislation** - principally, the *Fair Work Act 2009* (**FW Act**), which establishes minimum entitlements, gives force to the statutory instruments described below and creates various protections for employers, employees and other participants in the workplace. The FW Act includes the NES, which is comprised of 10 minimum entitlements widely considered to the be the baseline of employee entitlements in Australia.



(b) **Modern Awards** - instruments which set out minimum terms and conditions for employees in specific industries or occupations, and have force under the FW Act.

[2] *Scott Harrison v FLSmidth Pty Limited T/A FLSmidth Pty Limited* [2018] FWC 6695.

(c) **Enterprise agreements** - collectively negotiated instruments covering one or more employer(s) and relevant groups of employees, which are again given force by the FW Act. Enterprise agreements displace modern awards which would otherwise apply, however enterprise agreements generally must ensure that employees are better off overall under the enterprise agreement as compared to the award. To do so, enterprise agreements may only be approved by the Fair Work Commission (the **Commission**) where the enterprise agreements meet the Better Off Overall Test (the **BOOT**). As enterprise agreements typically include superior terms and conditions as compared to applicable awards, unions derive great value in bargaining with employers for enterprise agreements in order to secure greater membership and "buy-in" from employees.

(d) **Contracts of employment** - agreements between individual employees and his or her employer. These operate subject to, but generally supplant, the other sources of rights and obligations described (and depicted) above.

Employment contracts encapsulate the terms of agreement between an employee and their employer. While legislation, awards and enterprise agreements set out certain minimum standards, terms and conditions, or obligations required during the employment relationship, a contract of employment provides freedom for employers to reach agreement with employees on other matters not contemplated by these instruments. Given the range of issues that might exist between an employer and employee, there are usually a number of matters that are regulated by a contract between the parties.

3.2 *Identifying applicable Awards*

Navigating modern awards to determine the award that applies to a specific role can be a difficult process. Most awards in the current industrial relations landscape fall into the following broad categories:

(a) **Industry Awards:** these awards apply to employers in particular industries – for example, the General Retail Industry Award covers non-managerial employees of companies operating in the retail industry. Whether an employer falls under a particular industry depends on the principal activities of the company.

(b) **Occupational Awards:** these awards apply to employees in particular occupations – for example, the *Clerks—Private Sector Award 2010* covers clerical employees. Employees' award coverage is based on the principal purpose for which they are employed rather than an assessment of the duties on which they spend their time. If an employee falls within the coverage provisions of two separate modern awards, the employee will be covered by the award most appropriate to the work and the work environment.

4 Determining the appropriate type of engagement

Employers and employees alike have long been familiar with concepts of casual, part-time and full-time employment. However, these typical work types are evolving in a landscape where there are significant shifts in the way that people perform work. In these times of change and uncertainty, it is important that employment contracts clearly identify the type of employment, and the consequences for both employer and employee. Employers that try to simplify employment contracts by using a "one size fits all" approach often create complications for themselves in the long term. This is because the type of contract required for a casual employee will be materially different to one required for a full-time salaried employee or an independent contractor.

4.1 *Casual employment*

A true casual employee is an employee who is employed per individual engagement, with no promise of ongoing work. On this basis, each working period offered represents the commencement and conclusion of a casual employee's employment.

Changes are afoot in the land of the casual employee, and it has never been more important for employers to ensure that contracts are appropriately drafted in order to best protect against future claims. There are two recent changes that are important to keep in mind when engaging casual employees and/or preparing casual employment contracts:

- the right to request casual conversation; and
- changes designed to prevent double dipping by employees who were treated as casual, but who a court has decided are actually part time or full time.

The right to request casual conversion has been introduced in the FW Act and modern awards and allows employees who have worked regular and systematic hours over a particular period to request that their employment is converted to that of a permanent employee, with commensurate entitlements. This is not an obligation that employers can "contract out of".

Separately, in August 2018, the Federal Circuit Court ruled in *Skene v Workpac Pty Ltd*[3] that a casual labour hire employee was in fact an employee entitled to annual leave payments. The judgment considered the terms of Mr Skene's labour hire agreement and the regular nature of the work he was performing and reached the conclusion that despite the way his employment had been characterised by the parties, he was indeed employed on an ongoing basis (largely due to the extended period over which was aware of his shifts and the advance commitment he made to carry out the work he was contracted to do). The Australian Government subsequently introduced a change to the Fair Work Regulations to ensure employers could argue that the casual loading that had been paid to an employee could be taken into account by a court in determining whether such an employee was entitled to receive any further payments form the employer.

These developments make it even more important for employers properly to consider, at the time of engaging the employee, that the employee is appropriately characterised. While having a written contract is not necessarily enough to refute such an argument, it is certainly a useful tool in the context of a well thought out engagement.

4.2 *Is this even an employment arrangement?*

The treatment of workers as "independent contractors", as opposed to employees, is becoming more common, especially in the growing "gig economy". Many organisations now also outsource project work and workers are increasingly engaging in "side-hustles".

As these trends grow, it is important that employers properly consider whether a worker should be treated as an employee or an independent contractor before engaging the worker. Penalties for "sham contracting" can be significant - let alone the risk of needing to make back payments for wages and salary.

The courts use the multi-factor test[4] when considering the basis on which a person is to be treated. A highly publicised example of how things can go wrong when workers are mischaracterised is the ongoing saga in relation to Foodora's now defunct Australian operations. In November 2018, the FWC ruled[5] that a former Foodora rider was an employee rather than an independent contractor - and that he had therefore been unfairly dismissed. This then called into question the entire Foodora business model, which (seemingly) depended on riders being independent contractors. The decision (and the fallout) highlight the importance of ensuring that the proper characterisation is applied to workers. In its IR platform for the forthcoming 2019 Federal election, the Australian Labor Party has specifically called out that it will "*strengthen the laws that prohibit sham contracting*".

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3 *Skene v Workpac Pty Ltd* [2018] FCAFC 131.

4 There are a number of factors to be taken into consideration when determining whether a contractor relationship is legitimate as opposed to a "sham" arrangement aimed at avoiding payment of employee entitlements such as leave and superannuation.

5 *Joshua Klooger v Foodora Australia Pty Ltd* [2018] FWC 6836

5 Getting the foundations right - the key terms to include in employment contracts

In order to ensure that employment contracts meet the three key pillars of clarity, flexibility and protection (as set out above), the following key clauses should be included.

5.1 *Clauses to include for the sake of **clarity***

Clause	Reasoning
Type of engagement	As set out above - is the worker employed on a full-time, part-time, casual or maximum-term basis? Are they an independent contractor? Consider which type of engagement will work best for the role being filled.
Remuneration	A fulsome remuneration clause will include, if appropriate, an annualised salary term,[6] guarantee of annual earnings term (as discussed above) and that the employee's salary will be reviewed annually (but with no guarantee that it will be increased).
Set off clause	A set off clause is particularly useful where an employee is covered by a modern award and is paid above the minimum amount specified by that instrument. A set off clause basically states that the extra payment is made in satisfaction of all award entitlements. A set off clause can prevent claims of underpayment, but not breaches of an applicable award.
What is the employee required not to do	Ensure that the contract is specific in what restrictions or prohibitions apply to the employee's employment. While it may be that some prohibitions will sit in the employer's policies, the key, serious prohibitions should be included in the employment contract (for example, a prohibition on acting in conflict with the employer and the employer's company.

5.2 *Clauses to include for the sake of **flexibility***

Clause	Reasoning
What is the employee required to do	Ensure that the contract includes the duties and obligations that the employer requires of the employee, and balance this with flexibility to ensure that the employer can direct an employee to perform other duties to meet changing business needs. To maintain flexibility these clauses can be kept high level and refer to the way in which the employee is expected to perform (eg. diligently or professionally) rather than a focus on the specific duties that they are required to perform.
The ability to direct the employee to	An employment contract should enable the company to direct an employee to perform different duties or to not perform work at its discretion. For example, the ability to suspend an employee during an investigation.

[6] Annualised salary terms are used to counteract specific award provisions such as overtime, allowances and leave loadings. To be enforceable, the arrangement must be agreed in writing, be placed in the contract and specify the precise award conditions that are being replaced. In addition to this, the salary must be reviewed annually.

Clause	Reasoning
work and not to work	
Hours of work	A basic of a good employment contract is clearly specifying the hours of work that an employee is expected to perform. This includes any overtime requirements or expectations (for salaried employees) relating to reasonable additional hours.
Probation periods	It is available to the employer to choose to include a probation period term in employment contracts for new employees.
Location of work	As set out above this is important if there are multiple locations from which an employee may be required to work, and especially if they are intended to work from home for any part of the employment.

5.3 *Clauses to include for the sake of **protection***

The employment contract should contemplate the termination of the employment, including the employer's expectations of the employee with a focus on those obligations which continue after the employment ends.

If an obligation is intended to outlive the employment relationship, it must be put in writing. Once the employment relationship ends, the company will no longer be able to rely on its ability to direct the employee and ideally should have a contractual obligation to rely upon.

Clause	Reasoning
Intellectual property	Detailed clauses regarding an employee's obligations regarding intellectual property are essential - particularly in industries such as IT, robotics, design, etc.
Confidential information	Terms relating to confidential information should be specifically tailored to the employer's business, including by specifying what information is considered to be confidential. It may also be worth noting that employees have obligations arising under s 182 of the *Corporations Act 2001* (Cth), that is that an employee will not improperly use their position to gain an advantage for themselves or someone else, or to cause a detriment to their former employer. Confidential information clauses are essential even for lower level employees, as employees at all levels in the company typically have access to some confidential information which should be protected.
Termination of a fixed term, maximum term or indefinite contract	Apart from issues that arise when a fixed term, maximum term or indefinite contract expires and an employee continues to perform work, these contracts may also create a situation where the employee is found by a court or tribunal to have become a 'permanent' employee and thus be entitled to benefits such as access to unfair dismissal claims.
Summary dismissal	A summary dismissal term should be included to address situations of serious misconduct. Where this occurs, an employer can summarily dismiss with no notice and no requirement to make a payment in lieu of notice.

Clause	Reasoning
Notice of termination	A notice of termination clause should include: • the length of the notice period; • whether or not the notice period is affected when an employee gives notice during their probationary period; and • an ability for the employer to direct an employee to take gardening leave during the notice period. A failure to specify a notice period will lead to a situation where an employee is entitled to 'reasonable notice' the length of which will depend on many issues.
Payment in lieu of notice	It is important that employment contracts provide that an employer can make a payment in lieu of notice. This can be particularly important where, for whatever reason, the employment relationship has broken down or the employer wishes to exit the employee from the business without the need for the employee to serve out their notice.
Deducting amounts due	An employer is not prohibited from including in an employment contract that it will, to the extent permitted by law, deduct amounts from an employee's salary: • that are required by law or Court order to be deducted (eg. Taxation); • that were overpaid to the employee by the Company; • which an industrial instrument specifies or permits may be deducted; and • agreed between the employee and the employer.
Restraints	Post-employment restraints of trade are, in the first instance, void as against public policy. The courts, as a general proposition, regard employee choice and free competition should be regarded as desirable and facilitated. However, a court will uphold a post-employment restraint if, and only if, the restraint goes no further than is reasonably necessary to protect the legitimate business interests of an employer. The 'reasonableness' of the post-employment restraint must be established by the employer, and the courts will not protect an employer against mere competition. The 'reasonableness' of a post-employment restraint is assessed as at the time the contract is entered into - as opposes to when the employer seeks to enforce the restraint. An employer may have a legitimate business interest in protecting confidential information, trade secrets, customer connections, and/or staff connections. Employers are increasingly seeking to enforce restraints of trade in order to protect their interests, particularly in industries or markets where customer patronage or market share is tightly held. To maximise the prospect of a post-employment restraint being valid, for each employee, careful consideration should be given to:

Clause	Reasoning
	(a) which restraints (eg. non-compete, non-solicit and/or non-poach) are appropriate? (b) what is the reasonable duration of the restraint? Consideration should be given the periods that will be necessary for each restriction. (c) what is the geographic area that each restraint should apply in? (d) should the clause be limited to the employing company or the broader group? Generally, restraints should be limited to the employer company, unless you can identify why the broader group is necessary (eg. an executive may have knowledge of or influence over these companies).

5.4 *Clauses that may be optional/could be deferred to other instruments*

Speaking broadly, anything that an employer is required to do by law does not need to be expressly included in an employment contract. Noting that instruments such as modern awards are also changed from time to time, there is a benefit in referring to an applicable instrument as guiding the terms of employment without reproducing it in the employment contract itself.

Clause	Reasoning
Leave entitlements	The NES provides for these entitlements, unless an employer intends to offer enhanced leave entitlements simply pointing to the entitlements in the NES or company policy is sufficient in order to avoid detailing lengthy leave terms in contracts. With regard to long service leave, the entitlement varies from state to state, accordingly reference to the appropriate state legislation should be sufficient.
Notice of termination	Unless the employer wants to offer more generous notice periods, the minimum requirements are already provided for in the NES.
Redundancy pay	Unless the employer wants to offer more generous redundancy pay, the minimum requirements are already provided for in the NES.

6 How to deal with company policies and procedures in employment contracts

For a variety of reasons, it is common practice for employers to implement policies in the workplace which set out the expectations for employees in relation to particular matters or processes. For example, modern workplaces typically have policies regarding the use of social media, the use of IT equipment, bullying and harassment, workplace behaviour, occupational health and safety, dress standards and safe driving.

Employers also often set out some of the benefits that attach to employment in policies and procedures which apply to their employees. The rationale behind including specific detail in policies as opposed to contract is that policies can be implemented, varied, or withdrawn entirely at the discretion of the employer.

It is not uncommon for contracts of employment to be silent on the status of policies, or even simply to say that an employee must comply with them. However, that approach can create questions about whether terms of the policy were intended to be aspirational or binding and enforceable on the parties.

When it comes to dealing with policies in an employment contract, there are a few things for employers to remember:

- The contract should ensure that employees are informed that they need to comply with an employer's employment policies - but that they do not impose obligations on the employer; and

- Preferably, the relevant clause refers to the fact that the policies don't form part of the contract itself, and the employer can vary the policies as and when it sees fit. This approach provides employers with a high degree of flexibility to meet changing business needs.