BEAN KINNEY & KORMAN PC
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Employment Law Newsletter

Volume 6, Issue 2

April 2014

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Fairfax Circuit Court Strikes Down Noncompete as Overbroad, Offering Yet Another Lesson for Employers

By Jennifer Harper

On March 6, 2014, a Fairfax Circuit judge denied a preliminary injunction in a suit brought by Wings LLC to enforce a noncompete against two defector employees. In a letter opinion, Judge Bruce D. White said the noncompete was unenforceable because the geographical limits were overbroad. The ruling is not particularly unprecedented but offers another look into why noncompetes continue to get struck down and how to avoid it by examining the real business needs of an employer rather than imagined possibilities.

The Case

Founded in 1996 by John Kia, Wings LLC provides commercial and residential vinyl, fabric and leather repair services. Kia remains its sole owner. Technicians Jeffrey Manalansan and Cameron Fridey signed noncompetes when Kia hired them to work for Wings. The noncompete provided that the technicians could not, for 24 months after employment with Wings, directly solicit any customer that Wings serviced in the past 12 months prior to their departure. The noncompete also prohibited the technicians from accepting employment "in a position that is the same, or substantially the same" as their job with Wings with any business that had, within the past 12 months, provided "material, labor, or services" that competed with Wings. The restriction applied to "any U.S. state or foreign country in which the employer had conducted business during the 12 months prior to the employee's departure."

In late 2013, Manalansan and Fridey resigned from their positions at Wings. Kia then learned that Manalansan resigned from Wings to work for Kia's son, who owned a competing company, and that Fridey was thinking of doing the same. Seeking an injunction against the former employees, Wings asserted that both Manalansan and Fridey violated their noncompete agreements. Wings asserted Manalansan was working as a technician for Capitol Leather, LLC, the competing business owned by Kia's son, and Fridey was observed working at dealerships that were Wings customers.

Applying the usual four-factor test for injunctive relief, Judge White found the likelihood of winning on the merits was low because the agreements were unenforceable as geographically overbroad. White noted that, in the past 18 months, Wings served customers mainly in Northern Virginia, southern Maryland, and West Virginia. But the geographical scope of the noncompete was worldwide and Wings had no business interest beyond the local metropolitan area.

Even in the local area, Judge White found the restriction too broad. Although Wings' customer market was limited to certain regions, the technicians nevertheless "would be prohibited from working as technicians for two years throughout the entire states of Virginia, Maryland and West Virginia and possibly in Washington D.C." While a two year restriction might have been reasonable on its own, White added that, combined with such a broad geographical range, the noncompete simply became untenable. "As with geographic restriction, Plaintiff put forward no evidence as to why a restriction that lasts for two years was narrowly tailored to meet a legitimate business interest."

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The Takeaway – Tailor Restrictive Covenants to Meet Actual Needs, Not Potential Future Goals

Judge White's decision underscores the importance of good drafting. But it also raises another point about when to use a noncompete and when other tools such as a non-solicitation and confidentiality agreement would better serve an employer's business goals. Wings' noncompete clearly suffered from overbreadth. Its geographical scope was worldwide but Wings did not conduct business beyond the Washington D.C. metropolitan area and part of West Virginia. Worse, it only conducted business in certain regions of Virginia, Maryland and West Virginia. This might not have doomed Wings' noncompete if the duration was 6 months or possibly a year, and it would have taken on new life if the noncompete period was paid. But the restriction spanned the United States and any foreign country for a full two years without qualification. Regardless of time limits, the idea that Manalansan or Fridey could not accept a technician's job in, say, Great Britain was indefensible. Judge White had no choice but to strike it down.

Such an outcome was not unexpected. A worldwide geographical range is not per se unenforceable, but it must be based on legitimate business interests and, traditionally, the remaining restrictions (duration, function) must be very narrowly tailored. Wings' noncompete was missing all of these components, so it was destined to fail.

Also, Wings did not draft the noncompete to correspond to its actual needs. Wings needed to protect its customer base from being pilfered by Kia's son's business. A realistic examination of the actual span of Wings' customer base would have led to a more narrow geographic range. Instead, like many employers, Wings imagined potential future competition in places the company had not yet conducted business. This view is simply too speculative for a noncompete to be enforceable. For example, Wings had no existing business in foreign countries and there was no indication it was forthcoming. To include foreign countries in the range of competition is merely prospective. Noncompetes aren't intended to foretell the future of the competitive market—they can only protect against unfair competition in the present. Thus, noncompetes are most effective when the restrictions are limited to locations where business is currently being conducted and existing customers are located. Employers should approach the element of geographical range with the present in mind.

The Role of Noncompetes – Protecting the Investment

A closer look at this case also reveals a common misunderstanding about the purpose of noncompetes. Put simply, a noncompete is designed to protect a business from losing its investment. This can be seen most clearly in the context of a business sale. When one person buys a Pizza Hut franchise from its owner, the person also "purchases" the customer market that comes with it. If the former owner then opens a Little Caesar's across the street, the purchaser's investment is severely compromised in the form of lost customers and lost profits. A noncompete prohibiting the former owner from engaging in the same or similar business within the customer market for a sufficient period of time will help protect the purchaser from being undermined by immediate competition. And it prevents the seller from double-crossing the purchaser by profiting twice—once from the sale of the Pizza Hut and again from the profits made from Little Caesar's.

Similarly, when an employer invests in an employee for purposes of maintaining its competitive edge, it does not want to lose that edge to a competitor after the employee leaves. Here, the noncompete is designed to prevent the former employee from using the employer's investment for personal profit, either individually or on behalf of a competing business (for which the former employee likely will be handsomely rewarded). With a noncompete, the employer's investment is protected from being leveraged by a competitor. The employee is permitted to take another job, but not for purposes of using the employer's investment against it.

When Is a Non-Solicitation and Confidentiality Agreement a Better Option?

When the issue is mainly preserving an employer's customer base, a noncompete is not always the best vehicle. This is because of the legal restrictions placed on noncompetes such as the requirement of a reasonable geographic range. Customers can be located all over the world but that is not always equivalent to the principle of protecting a business's legitimate interest in its investment. For example, an employer with a customer base in Maryland and Virginia has no real interest in Ohio. If its employees move to Ohio and perform similar jobs, there should be no legal penalty against the employees. Thus, a noncompete prohibiting an employee from taking the same or similar job in Ohio almost certainly will be held unenforceable. Likewise, if an employer has customers in Ohio, but only occasionally conducts business with those customers, or the breadth of the customer base is very narrow, its interest in Ohio is too small to have a noncompete covering the entire state.

The better option in both cases is to execute a non-solicitation and confidentiality agreement. A non-solicitation and confidentiality agreement bridges the "investment" gap by preserving the employer's customer market without succumbing to the legal limitations of a noncompete. Wings had a non-solicitation agreement but also relied on its noncompete agreement. The noncompete was overbroad, but stronger non-solicitation and confidentiality agreements would protect a company from losing its customers to a competitor, which was the real loss Wings seemed to have suffered. It would also protect against the improper use of Wings' confidential business information that gave it a competitive edge in the market, preventing Capitol Leather LLC from using Wings' former employees to undermine Wings' business. A separate non-solicitation and confidentiality agreement would ensure that, even if a noncompete fails, the restrictions on pilfering customers and using an employer's strategic information against it would remain intact. When drafted well, these agreements preserve fair competition even if former employees move to a competitor.

Using Restrictive Covenants Smartly

Although disfavored, noncompetes in Virginia are still enforceable. The key is to use restrictive covenants smartly. Employers should consider using noncompetes for protecting their business investments against unlawful competition, but consider relying more on non-solicitation and confidentiality agreements to protect their actual competitive position. Understanding when and how to use both can mean the difference between a triumphant victory in court over a costly loss.

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No WARNing of Bankruptcy?

By Andrea Campbell Davison

When Reston-based Simplexity, LLC (known more commonly as Wirefly.com and its related sites) recently filed for chapter 11 bankruptcy it had, sadly, already terminated nearly its entire workforce. According to pleadings filed in the case, Simplexity had hoped to market and sell its assets outside of bankruptcy in order to maximize creditor recovery and preserve the jobs of its employees. Instead, its liquidity reached such a critical level that it was forced to cease operations on March 12 and file for bankruptcy protection on March 16, 2014. Just one day later, on March 17, a proposed class action adversary complaint was filed against Simplexity, alleging violations of the WARN Act on behalf of 350 of its employees.

The WARN Act

Codified in 1988, the Federal WARN Act (29 U.S.C. §§ 2101-2109) provides that a business enterprise that employs 100 or more employees must provide at least 60 days advance written notice of any "plant closing" or "mass lay-off" to each employee who will be terminated. A "plant closing" is a shutdown (permanent or temporary) that results in the loss of employment of 50 or more full-time employees at a single site of employment. A "mass layoff" is the loss of employment of 500 or more people or the loss of employment of at least 50 employees constituting more than 33 percent of the full-time employees at a single employment site. The purpose of the WARN Act was to protect workers, their families and communities by providing fair notification of an impending layoff. The hope was that with 60 days' notice, workers could seek other employment, pursue skill training or otherwise adjust to the future job loss. Employers who fail to provide the required notice are liable to each terminated employee for a full 60 days' pay and benefits.

Although employers must still provide notice as soon as practicable, there are three stated defenses to the 60 day notice requirement under the WARN Act:

(1) when an employer reasonably believes that advance notice would impede its active pursuit of capital or business;
(2) unforeseeable business circumstances; and
(3) natural disasters.

Some employers have also defeated WARN Act claims by asserting that, at the time of the layoffs, it was no longer a business enterprise but simply a "liquidating fiduciary" that does not fit the Act's definition of an employer.

Bankruptcy Implications

Somewhat naturally, companies seeking bankruptcy protection are often forced to abruptly terminate employees before providing the required notice. In addition to developing the "liquidating fiduciary" principal discussed above, bankruptcy courts have examined, and often disagreed, about certain applications of the WARN Act once the "employer" is bankrupt.
It is somewhat well-settled law, at least in the circuit where the Simplexity case is pending, that WARN Act claims may be brought as an adversary proceeding. This is based on the principal that WARN Act claims are equitable in nature because they seek reimbursement of salary and benefits due to them, rather than damages resulting from their termination. Some courts have disagreed, however, in cases like Simpexity where the notice was due and/or the termination occurred pre-petition, and have

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relegated WARN Act claims to be adjudicated during the general claims allowance process in the bankruptcy case.

Although their adversary proceeding is unlikely to be dismissed as improperly brought as an adversary proceeding, former Simplexity employees may still face challenges to their claims. Simplexity claims to have had only “219 employees and 285 full time equivalent contractors” split between at least two separate locations – raising questions as to whether the employees or the “site” fall squarely into the Act’s definitions. Still, many bankrupt companies have been forced to pay millions in settlements with their former employees for WARN Act violations, and Simplexity may be no exception.

In re Symplexity, LLC, et al., is pending in the United States Bankruptcy Court for the District of Delaware (Case No. 14-10569).

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Department of Labor Further Delays Publication of its Final “Persuader” Rules

By Jennifer Harper

The U.S. Department of Labor (DOL) has once again delayed publication of its final rule on “persuader activities.” The DOL’s final rule was initially scheduled for publication in November 2013. As that date approached, the DOL rescheduled publication for March 2014. Having now hit that mark, the DOL once more has pushed off publication—this time without setting a future date. The new date is expected to be announced in the DOL’s Spring 2014 Regulatory Agenda.

In June 2011, the DOL published revisions to the persuader rule which broaden the scope of an employer’s reportable union-related activities by substantially limiting the application of the “advice” exemption in Section 203(c) of the Labor-Management Reporting and Disclosure Act (LMRDA).

The LMRDA imposes certain financial reporting and disclosure requirements for labor organizations, their officers and employees, employers, labor relations consultants, and surety companies. The LMRDA defines a labor relations consultant as “any person who, for compensation, advises or represents an employer, employer organization, or labor organization concerning employee organizing, concerted activities, or collective bargaining activities.’’ 29 U.S.C. 402(m).

Sections 203(a) and (b) of the LMRDA currently require employers and their labor relations consultants to report any agreement or arrangement between them where the consultant will undertake activities, directly or indirectly, to “persuade” employees regarding their right to organize a union and bargain collectively (i.e., “persuader activity”). If employers and consultants fail to comply with these reporting requirements, they could face jail for a year and a $10,000 fine.

Section 203(c) provides an exemption to the reporting requirements for labor relations consultants who give or agree to give merely “advice” to employers. The DOL originally interpreted the advice exemption to exclude from the reporting requirement any agreement or arrangement where the consultant has no direct contact with employees and the agreement limits the consultant’s activity to providing the employer and its management team with advice or materials for use in persuading employees regarding union-related activities.

However, the DOL concluded that this created a loophole which led to substantial under-reporting of persuader activities. To rectify the problem, the DOL proposed a new rule that required an agreement or arrangement to be reported if the consultant engages in activities that go beyond the “plain meaning” of advice. The term “advice” is defined as “an oral or written recommendation regarding a decision or a course of conduct.”

By contrast, “persuader activity” is expanded to include “providing material or communications to, or engaging in other actions, conduct, or communications on behalf of an employer that, in whole or in part, have the object directly or indirectly to persuade employees concerning their rights to organize or bargain collectively, regardless of whether or not the consultant has direct contact with workers.” Under the proposed rule, persuader activities include:

- drafting, revising, or providing materials or communication of any sort, to an employer for presentation, dissemination, or distribution to employees, directly or indirectly;
- developing or administering employee attitude surveys concerning union awareness, sympathy, or “proneness”;
- training supervisors or employer representatives to conduct individual or group meetings designed to persuade

employees;
- coordinating or directing the activities of supervisors or employer representatives to engage in the persuasion of employees;
- establishing or facilitating employee committees;
- developing employer personnel policies or practices designed to persuade employees;
- deciding which employees to target for persuader activity or disciplinary action; and/or
- coordinating the timing and sequencing of persuader tactics and strategies.

Reporting persuader activities would be required whether or not the agreement or arrangement also calls for advice. Under the proposed rule, if the object is to persuade employees then the reporting requirement is triggered:

> [W]here the lawyer or labor consultant has gone beyond mere recommendation and has engaged in actions, conduct, or communications with the object to persuade employees, either directly or indirectly, about the employees' protected, concerted activity … these activities, whether or not the consultant is in direct contact with the employees, trigger the duty to report.

"Reportable activity" would also include supplying information to an employer concerning the activities of employees or a labor organization in connection with a labor dispute.
No report would be required if the agreement or arrangement exclusively provided advice to an employer, such as when a consultant exclusively counsels employer representatives on what they may lawfully say to employees, ensures a client's compliance with the law, or provides guidance on NLRB practice or precedent.

If the DOL's final rule tracks the one proposed in June 2011, employers who hire consultants and attorneys to advise them regarding union-related activities will have to publicly file reports with the government detailing the engagement agreement, the scope of work, and the payment for such work, even if the consultant has no direct contact with employees. If the employer is a federal contractor, the final rule would run in conjunction with Executive Order 13494, which requires federal contractors to exclude from any billing, claim, proposal, or disbursement the costs incurred in undertaking activities to persuade employees regarding their right to organize and collectively bargain. The government will need to reconcile this conflict, most likely by amending the Executive Order to conform to the final rule. Legal challenges to the DOL's proposed changes are almost certain to occur. But until the final rule is published, the ultimate fate of the revised "advice exemption" remains to be seen.

Link to the DOL's proposed rule on the advice exemption: http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=25125&Month=6&Year=2011.

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FLSA Class Action Case Against Dollar Tree Goes Forward

By Jennifer Harper

On March 7, 2014, Judge Raymond Jackson of the U.S. District Court for the Eastern District of Virginia denied Dollar Tree's motion for de-certification of a Fair Labor Standards Act (FLSA) class action case involving between 4,000 and 6,000 current and former employees. The lawsuit alleges that Dollar Tree required or permitted its hourly associates and assistant store managers to work "off the clock" and overtime without compensation. The suit covers employees in Dollar Tree stores located in 48 states and the District of Columbia. Dollar Tree's headquarters is located in Norfolk, Virginia.

In their class action suit, the plaintiffs allege they were required to work off-the-clock without pay (1) when making bank deposits, (2) during interrupted meal periods, and (3) at miscellaneous other times performing activities such as unloading trucks, stocking inventory and aisles, retrieving carts and boxes, cleaning, and waiting for other employees to start the next shift. Although Dollar Tree had corporate policies which strictly prohibited off the clock work, the plaintiffs claim it was rarely enforced in practice. The plaintiffs claim they were forbidden from writing off the clock work on their time sheets. In some cases, no time sheets were filled out or the time keeping system in place didn't allow employees to enter off the clock work. Some employees interviewed explained they never included off the clock work on their time sheets for fear of discipline.

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The lawsuit further alleges Dollar Tree took no meaningful steps to rectify this problem. On the contrary, Dollar Tree's own corporate practices appeared to contribute to the problem. According to the complaint, Dollar Tree's corporate office imposed severe budget constraints and rules around employee pay. When faced with an overload of work to be completed in a short timeframe, local store managers had to get the work done within a tight payroll budget. This may have led to employees working off the clock in an effort to meet corporate deadlines.

In requiring or permitting managers to engage in this practice, Dollar Tree put itself in a dangerous position. The FLSA requires employers to pay non-exempt employees for all work performed. In general, that means any work performed off the clock, during breaks and meal times, while waiting for the next shift to arrive, and the like, must be paid. It is up to the employer to enforce the rules prohibiting off the clock work and to discipline managers and employees who do not comply. Regardless, the hours worked must be compensated.

Dollar Tree may be learning an expensive lesson about policies versus practice. Policies are only as good as the conduct it regulates. If policies are not properly enforced it can lead to unwritten rules and practices that casually evolve over time. But casual practices regarding employee pay can easily lead to a violation of federal and state wage laws. Such a mistake can cost a company millions of dollars in damages.

The judge's denial of Dollar Tree's motion for de-certification foretells potential settlement, but it would be hasty to conclude that Dollar Tree as a company intended to deny their employees pay as opposed to bearing responsibility for the decisions made by its management. Trickle down management can fail to reveal problems until it's too late. Work-related issues can be missed, overlooked, or created unwittingly as often as they are caused deliberately. Awareness of existing issues can also get caught in a communication bottleneck that hinders prompt remedial action.

What This Means for Business Owners

"Information blocks" can be avoided. Frequent on-site monitoring of local stores can uncover inappropriate practices sufficiently in advance to rectify the problem. Extensive training of employees and managers at all levels should be conducted regularly, both at the time of hire and every year afterward. Policies should be easy to understand and easily accessible to employees. In addition, they should be consistently enforced by those in authority. Random checks by supervisory personnel should be done with written reports submitted up through the chain of command. A hotline can be installed to encourage management and employees to report potential problems as they arise. Audits should be conducted at appropriate intervals and thorough investigations should be conducted every time a complaint is reported. Ideally, businesses should use experienced attorneys who are not employed by the company to examine large-scale issues or complaints that carry a high risk of liability. But all relevant personnel should have specific training for investigating day-to-day internal complaints. Executive personnel should make it a priority to review the potential impact of business decisions such as budget constraints on the job performance of their employees.

These measures can be time-consuming and costly to implement. Not all businesses can afford to do them all. But the high return in doing something as simple as creating more effective oversight will pay off handsomely when conduct like off the clock work is prevented well before it becomes a costly lawsuit. The class action lawsuit against Dollar Tree is an eye-opening case in point.

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