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Business and Employment Law Update

First Quarter, 2005

SUCCESSION PLANNING: HOW TO GET YOUR BUSINESS TO GIVE YOU THE FUTURE YOU WANT

By Sallye Quinn

A recent article in *The New Yorker* detailing the demise of Mike Ovitz's relationship with Disney put a spotlight on succession planning gone bad. When Michael Eisner was lying in bed after suffering a major heart attack, Ovitz was the one to provide support for Eisner's wife, arrange details and generally take control. Based on those actions, Ovitz success in Hollywood and the Eisner and Ovitz families' friendship, Eisner's wife encouraged Eisner to hire Ovitz at Disney to be his partner and eventual successor to the throne. The ultimate fallout was a well-publicized lawsuit against Disney by its shareholders for Ovitz's eventual firing and receipt of $140 million dollar severance package during which Eisner called Ovitz devious, untrustworthy and a pathological liar. Who was more to blame for the decision to hire Ovitz and the ultimate destruction of the careers of two very powerful men will probably never be known, but the story and all its intricacies certainly proves that truth is, if not stranger, at least more interesting than fiction. What can the average business owner learn from the Disney saga? Certainly that it is difficult to do business with friends, but more practically, when looking to implement a succession plan so that your business can give you the future you want, planning and careful consideration are key.

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EMPLOYER ALERT: NEW FEDERAL OVERTIME RULES TOOK EFFECT AUGUST 23, 2004

By Amy Robinson

In an attempt to update and clarify the Federal Labor Standards Act (FLSA), and particularly the overtime exemptions for executive, administrative, and professional personnel, the U.S. Department of Labor rewrote the federal regulations just last year. These new rules went into effect on August 23, 2004. See 29 CFR § 541.

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Succession Planning, continued…

Most business owners are so caught up in the day to day operations of their business that they don't stop to think about who will own the business when they're no longer there to do it, whether as a result of causes within their control (retirement) or outside of their control (illness, disability or death). Therefore, planning ahead is a must. The first step is to define what you want. Do you want to leave a legacy and make plans to maintain your business and its current operation when you're not there any longer? Do you simply want to be able to reap the benefit of your investment by selling your company to a buyer who will do as they wish with the company? Or, do you want a little of both? Once you decide how you see your business working for you in the future, the next step is to identify the person or persons to make that happen for you.

Accordingly, the second step is to identify the successor. If you want to maintain a legacy, maybe that successor is a family member or members or a current employee who shares your vision for the company and who you can trust to honor your wishes. If that's the case, now is the time to begin talking with that person about how you'll eventually hand over the reins and to begin grooming that person through training and teaching to be prepared to take over when you're ready to give them the reins. In addition to grooming, you need to have a clear understanding, in writing, as to how ownership will pass. You may have an operating agreement or shareholders agreement that spells how ownership will transfer. If you don't otherwise have an agreement in place, now is the time to put one in place to make sure that transferring your ownership, either through gift or sale, maximizes the value of the business. Alternatively, if your potential successor is simply a category of potential buyers, you need to begin defining who those buyers might be and then determine what will add the most value to your business so that you can obtain the highest price when it comes time to sell.

Last, even with the best of planning, the unexpected can happen. As such, it's important to have a plan in place as to how the company would continue if you, unexpectedly, weren't able to run the business. For example, one of our client's succession plans was to sell his business to a third party. However, during the period of time while he found a buyer for his company, he had in place a complete and

Succession Planning, continued…

detailed notebook describing every aspect of his business so that, in the event of death or disability, his family could step in a keep the business going. This type of planning is critical to ensure that you receive all the value you've put into your business.

DUE CONSIDERATION: MAKE SURE YOUR NON-COMPETITION AGREEMENTS ARE ENFORCEABLE

By Amy Robinson

There is a new challenge for employers in the ever-evolving world of Non-Competition Agreements or "Non-Competes." The Washington Supreme Court recently ruled that Non-Competition Agreements entered into between an employer and an existing employee may be invalid if an employee was offered nothing more than continued employment in exchange for the Agreement. *Labriola v. Pollard Group, Inc*., 100 P.3d 791 (Wash. 2004).

In *Labriola*, an employer engaged in the custom printing business sought to enforce a Non-Competition Agreement that was entered into with an existing salesperson five years after he was hired. *Labriola v. Pollard Group, Inc*., 100 P.3d 791 (Wash. 2004). The terms of the agreement prohibited the employee from accepting employment with a competitor for a period of three years, anywhere within a 75-mile radius of the city of Tacoma. *Id*. Finding that the employee received nothing more than the employment and training opportunities that he had already enjoyed prior to signing, the Washington Supreme Court in November of 2004 refused to enforce the Agreement:

> Our decision today, contrary to Employer's contention, follows this court's jurisprudence that independent consideration is required at the time promises are made for a noncompete agreement when employment has already commenced. [citation omitted] While continued employment and/or continued training may serve as sufficient consideration, it certainly was not the case here. [citation omitted] Accordingly, we hold that the noncompete agreement is not supported by consideration and is not enforceable.

Labriola, 100 P.3d at 796.

Due Consideration, continued…

This case makes it clear that Washington employers who want to gain the full protection afforded by a Non-Competition Agreement must offer existing employees something of additional value as consideration for the agreement. This "new" consideration may include increased wages, a promotion or status advancement, a bonus, additional benefits or increase to existing benefits (i.e. an extra week of vacation per year), a fixed term of employment, particularized training, or access to protected or proprietary information such as customer lists or contact information. Since determining the enforceability of these agreements often becomes a highly fact-specific inquiry by the courts, employers should be sure to include references to the additional value offered to the employee in the text of the agreement itself.

It is important to note that *Labriola* does not alter the general rule that Non-Competes entered in connection with the initial job offer continue to be enforceable, provided they are clearly made known to the employee as a term of employment before it has begun.

New Federal Overtime Rules, continued…

Both state and federal wage and hour laws continue to mandate that employees be compensated at a rate not less than one and a half times their regular rate of pay for overtime. That compensation must be paid, unless the employee, by virtue of his role or responsibilities, is expressly exempted from the overtime provisions. These are referred to as "exempt" employees.

The FLSA has always required that a properly classified "exempt" employee (i.e. a salaried employee who is not eligible for overtime) meet both a "salary test" and a "duties test." That is, the employee must earn both the requisite minimum weekly salary and have regular duties consistent with the standard for the exemption that the employer is claiming.

While an employer must still demonstrate that an employee meets both tests to claim an exemption under the new rules, the tests themselves have been modified. Perhaps most importantly, the minimum salary level for an exempt employee has been raised to $455 per week. This test must be met before it is

New Federal Overtime Rules, continued…

necessary to determine whether the employee also performs the requisite duties to support a claim of exemption.

There have also been significant changes to the "duties tests" in determining exemptions. This test is good evidence of the importance of maintaining up-to-date, detailed, and accurate job descriptions for your employees. As many employers are probably aware, the "duties tests" are unique to particular positions and there are a variety to choose from, including computer professionals, outside salesperson, or professionals. Some of the most relevant changes under the FLSA's revision include:

- Executive Exemption. In addition to having primary duties involving the management of an "enterprise, department or subdivision" of an employer, and supervisory responsibility for at least 2 employees, a properly classified exempt executive employee must now also have hiring and firing authority. In the alternative, the rules permit that the employee's suggestions and recommendations regarding hiring and firing be given "particular weight."
- Administrative Exemption. While no substantive changes were made, the federal regulations added some clarity to the meaning of "discretion and independent judgment" that must be exercised by an administrative employee to be properly classified as exempt. Some examples include:
  - Authority to formulate, affect, interpret, or implement management policies or operating practices.
  - Authority to commit the employer in matters that have significant financial impact.
  - Authority to negotiate and bind the organization on significant matters.
- Outside Sales Exemption. The federal regulations no longer apply a 20% limitation on activities that are not sales related and therefore do not qualify as exempt work.

  Please note: Washington's Minimum Wage Act continues to apply that limitation.
- Highly Compensated Employee Exemption. This is a brand new exemption available to

New Federal Overtime Rules, continued…

employers under the FLSA. This is a catch-all exemption that applies if the employee makes more than $100,000 per year and $455 per week.

These are only a few of the changes affecting employers. Of course, Washington's own wage and hour laws have not yet been modified to conform to the standards. Where the state and federal standards differ, Washington employers should take care to adhere to the more stringent standard until they have been brought into conformity.

To avoid wage-hour litigation and potential fines, employers need to be proactive to ensure that they are in compliance with the new standards, and meet the minimum requirements mandated by law. We recommend that you consult your human resource professional and/or legal counsel to formulate an action plan to address the relevant changes and ensure your business is in compliance with applicable wage and hour laws.

SARBANES-OXLEY - STILL CONFUSED?

By Sallye Quinn

It's been over two years since the Sarbanes-Oxley Act ("SOX") was enacted and yet the mere mention of the act still perplexes business owners. Many business owners know that SOX applies to business, imposes new, strict reporting requirements for companies and bans most loans to executive officers. However, what most business owners still don't know is, what does SOX mean to me? Chances are, if you've received this newsletter and are a business owner or executive, SOX doesn't even apply to you because SOX only applies to publicly traded companies and those companies planning on registering securities with the Securities and Exchange Commission. Even still, private companies are affected by SOX because the many in the business world view the requirements of SOX to be the standard by which companies will be judged. Here are a few areas of your business where you're likely to feel the impact of SOX even if SOX does not apply to you.

Third Parties

Entities wanting to do business with you or that you want to do business with are likely to require assurances that you're in compliance with SOX.

Sarbanes-Oxley, continued…

For example, lenders may require that your business have independent directors or an independent audit committee prior to approving a loan. Insurers may require certain SOX mandated factors such as financial statement certifications by your CEO and CFO prior to issuing D&O insurance and potential board candidates may require that you implement certain governance measures prior to accepting a position on your board.

Buyer and Investors

Potential investors in or buyers of your business are likely to insist on audited financials, assurances of auditor and audit committee independence, controls over and disclosure of insider transactions and the inclusion of a Management's Discussion and Analysis section to shed light on financial statements. Shareholders are also more likely to insist on greater disclosures.

Filing an IPO

If you're planning on going public, SOX applies to you. Accordingly, beginning compliance now is the key to meeting your anticipated filing deadlines.

Even if you're not required to implement various aspects of SOX because lenders, insurance companies or buyers and investors aren't requiring you to do so now, the fact is that instituting aspects of SOX will increase the value of your business and save you money as a risk-avoidance measure. Implementation of SOX as a part of your corporate governance has great potential to increase the value of your company by strengthening internal organization and procedures and elevating internal codes of conduct. In addition, regardless of whether SOX technically applies to private companies, courts are likely to look to SOX and apply SOX's standards by analogy when evaluating claims against a company or its directors and officers for fraud or financial mismanagement. Having put the SOX standards to work in your company could shield against these types of claims.

If you have further questions about articles in this Update, please contact the Authors of their respective articles at: 360-733-0212.

A PERSONAL NOTE FROM THE DEPARTMENT:
By Kirsten Barron

We hope that you find our Business and Employment Law Update informative and helpful. We enjoy finding topics and reporting new legal developments of relevance to our clients.

As we enter 2005, I wanted to take a moment to tell you who the players are on the Business and Employment Department team.

Kirsten Barron has enjoyed the new challenges of being a partner this past year. She begins her eighth year at Brett & Daugert at the helm of the Business Department and continues to focus her practice on business and employment issues.

Jack Grant continues to focus his practice on business and real estate transactions, including land use. One of Jack's projects this past year was working with interested citizens to improve the City's building permit process.

Sallye Quinn has finished her first year with us after relocating from the largest firm in Boise: Hawley Troxell Ennis & Hawley LLP, and continues to prove herself a smart, thoughtful lawyer with great judgment. Her practice is primarily focused on business and real estate issues as well as commercial litigation.

Amy Robinson brings great employment and human resource experience to the firm and has been invaluable to our department and the Litigation team in solving a myriad of complex legal issues. Her practice is focused on employment and civil litigation.

We are very excited about the coming year. We begin 2005 with a sense of excitement about our professional goals and a sense of gratitude for the amazing, wonderful clients we are privileged to serve.

The sense of gratitude we have also extends to all of you who have supported the firm in the face of the tragic loss of Dean Brett's son, Brian. As lawyers, we often walk with our client's through difficult personal and professional situations – thank you for walking with us.

Thank You!