



Business Brief

Business and Client Advisory

DOES YOUR EMPLOYMENT AGREEMENT VIOLATE PUBLIC POLICY?

Under California law, an employer generally may not prevent a former employee from going to work for a competitor, nor can the employer prevent a former employee from establishing a competitive business. Even if the employee executed a written agreement with his or her employer promising not to work for a competitor or start a competing business, such contractual provisions are unenforceable under California Business & Professions Code, Section 16600.

This law expresses a “fundamental public policy” of the State of California favoring the employee’s mobility and enterprise over the former employer’s economic security. Although such contractual provisions have been unenforceable for some time, they still appear in many employment agreements. In fact, attorneys have been known to purposely include non-compete provisions in employment contracts, hoping that the employee would be unaware that he or she is not contractually bound by them. Additionally, many employers and their attorneys have written letters to current, as well as former, employees reminding them of the non-compete provisions in their contracts, knowing that the law could not compel compliance, but hoping that the mere threat of litigation might dissuade the employees from competing with the employers businesses. Regardless of their effectiveness, such tactics are risky and ill-advised.

The California Court of Appeals has recently held that an employer’s use of an unenforceable non-compete agreement could result in the employer being held liable to the employee for interfering with the employee’s prospective economic advantage. The court has also held that making a potential employee’s hiring conditional upon the employee’s execution of a non-compete agreement violates public policy and that the inclusion of an invalid non-compete or non-solicitation clause in an employment agreement “may infect the enforceability of the entire employment agreement.” Under this reasoning, it follows that the mere threat, by an employer, to enforce a non-compete provision against a current or former employee, is a wrongful act which may subject the employer to liability.

The bottom line is that employers would do well to modify existing employee agreements to tie any non-compete or non-solicitation language to provisions involving the protection of trade secrets -- or to remove such language from the agreements altogether. Please feel free to contact this office with any questions regarding the drafting, review or modification of employment contracts or any other employee-related matter.

BEWARE OF GRANTING HOURLY EMPLOYEES FLEXIBLE WORK SCHEDULES

An hourly employee has child care issues and asks to work four, ten-hour days as opposed to the usual five, eight-hour days. Another hourly employee commutes a long distance to the office and makes the same request. Being considerate and understanding, and desiring to keep these employees, the employer grants both requests.

The arrangement works well for a year or two, until both employees leave on unpleasant terms, one feeling passed over for a promotion and the other not getting along with a new supervisor. Low and behold, the disgruntled former employees file claims for unpaid wages against the employer with the California Labor Commissioner. The basis for their claims: they did not receive overtime compensation for the hundreds of days on which they worked over eight hours.

Unfortunately, **it is likely the former employees will prevail and that the employer will be ordered to pay, not only overtime compensation for each and every day the employees worked over eight hours, but also interest accrued, substantial penalties and the former employees' attorney's fees.** Moreover, the employer will most likely have incurred its own attorney's fees defending the action. The end result is a catastrophic example of "the road to hell being paved with good intentions."

California law is clear: regardless of whether the employees requested these work schedules, the employer cannot avoid paying overtime compensation for time worked beyond eight hours per day. As demonstrated above, the results can be costly.

There are exceptions to this general rule, including instances where the employee needs to receive medical care for a specific period of time, such as physical therapy, and where the flexible hours are only worked within one specific pay period. Additionally, there are procedural mechanisms through which the employer and employees can agree to make the flexible schedule available to the entire work force. Nevertheless, employers must be very careful not to permit such flexibility to only a few employees at a time.

Vogt & Resnick provides labor law counseling to numerous companies as part of its employment law practice. Our firm represents employers before the Labor Commissioner, defends them against wrongful termination claims, in both state and federal courts, and provides seminars on all aspects of wage and hour compensation issues as a proactive measure. Please feel free to contact us with all of your employment law needs.

NEW REGULATIONS REGARDING RESTRICTED PROPERTY AND IRC SECTION 83(B) ELECTIONS

Generally, when an employee receives certain restricted property, like stock options, it is transferred to the employee subject to forfeiture and transferability restrictions. Until such restrictions lapse, the employee is not considered an “owner” of the property and is therefore not required to include the property as income. In this situation, Section 83(a) of the Internal Revenue Code (IRC) requires the employee to include, as compensation, (and pay taxes on) the value of the transfer, based on the future lapse date, allowing the employee to defer the inclusion of income until such time.

While this is the “standard” method by which restricted property is managed, the Internal Revenue Service (IRS) does provide an alternative. Section 83(b) of the IRC allows an employee the opportunity to include such property, as income, at the time of transfer, rather than waiting until the transfer restrictions have lapsed. Thereby, requiring the employee to include, and pay taxes on, the option value at the time of receipt.

If an employee decides to make an “83(b) election,” the compensation element in the transaction is closed at the time of transfer and the employee is immediately treated as the owner of, and an investor in, the property, for tax purposes. Thus, transmuting the restricted property from property received, as compensation (ordinary income property), to ownership of investment property (capital asset). Although, this transmutation may be beneficial to the employee, it is crucial to examine the employee’s reasons for making such an election.

If an employee is granted restricted property by his or her employer, the employee should carefully consider the following: (1) the effect the inclusion of such income will have on his or her current income tax situation; (2) the restricted period; (3) the possibility that the value of the property may increase (or decrease) during the restricted period, and by how much; and, (4) the projected tax bracket of the employee at the time in which the restrictions lapse. If the employee believes that the property is appreciating significantly, then he or she may be wise to make the 83(b) election, so the employee will recognize the income at a lower value, rather than at the estimated higher value, once the restrictions have lapsed. Regardless of the circumstances, an employee should consult his or her legal and tax advisor prior to making the election.

An 83(b) election must be made in accordance with IRS Regulations and Procedures. If the employee decides to revoke the election, Revenue Procedure 2006-31, recently issued by the IRS, provides revocation procedures. It is important to note that the IRS will only grant revocation where the election was made under a mistake of fact or, as the IRS defines it, an “unconscious ignorance of a fact that is material to the transaction.” However, miscalculation of property value (or declination in value) or the non-performance of an act that was contemplated at the time of transfer do not constitute a mistake of fact for this purpose.

If you have questions about 83(b) elections or revocations, employee stock options or other benefit plans, please feel free to contact our office.

MEMORABLE QUOTES

"...there are two men whom you should never go to court against unless you are dragged there; one is he who has more money than you have, and the other is he who has no money at all. With the former you may lose even if you are in the right, and with the latter you will lose even if you win." *Australianus*

"Lawsuit: A machine which you go into as a pig and come out as a sausage." *Ambrose Bierce*

"I was never ruined but twice: once when I lost a lawsuit, and once when I won one." *Voltaire*

"There are more lawyers in just Washington, D.C. than in all of Japan. They've got about as many lawyers as we have sumo-wrestlers." *Lee Iacocca*

"If you laid all of our laws end to end, there would be no end." *Mark Twain*

"Litigation is the basic legal right which guarantees every corporation its decade in court." *David Porter*

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