



EMPLOYER UPDATE

A recent collection of practical articles on
legal issues affecting Arizona employers

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FITZGIBBONS
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TRUST AND INTEGRITY ... A TRADITION



Is Your Customer List a Trade Secret?

If your company does not properly treat its customer list as confidential, neither will Arizona courts.

DENIS FITZGIBBONS

YOUR BUSINESS OWNS INFORMATION THAT IS CRITICAL to your success and that you need to protect from competitors and other outsiders. However, not everything that you think is confidential is protected as a trade secret.

In its 2013 *Calisi* ruling, the Arizona Court of Appeals provided useful criteria for what constitutes trade secret protection. The Calisi case involved a company's customer list that a former employee took with him when he left to join a competitor.

The Court of Appeals held that only those secrets "affording a demonstrable competitive advantage" will qualify as a protected trade secret. Further, Arizona law will not protect a company's information if the company has not taken appropriate steps to ensure that its information qualifies as a "trade secret."

The Court of Appeals cited several factors to determine whether a customer list qualifies as a trade secret.

First, a customer list may be entitled to trade secret protection when it represents a "selective accumulation of detailed, valuable information about customers - such as their particular needs, preferences, or characteristics - that naturally 'would not occur to persons in the trade or business.'"

In other words, a qualifying customer list must contain information that a company compiles *by virtue of its relationship with the customer*, not simply by gathering required contact information or purchasing a commercial list of prospects.

Second, a customer list may be protected if the company can show that it compiled the list by "expending substantial efforts to identify and cultivate its customer base, such that it would be difficult for a competitor to acquire or duplicate the same information."

Third, as noted above, another factor to consider is whether the information contained in the customer list "derives independent economic value from its secrecy, and gives the holder of the list a demonstrable competitive advantage over others in the industry."

Finally, courts will examine how the company handles its customer list. Is the list marked "confidential"? Does anyone who uses the list sign an agreement to maintain its confidentiality? If the company does not treat the list as confidential, neither will the courts.

Achieving Trade Secret Protection

To strengthen your claim that your customer list is a protected trade secret, start with the following:

- Include in your customer list more than mere contact information. The list should also contain types of services provided, notes from client meetings and phone calls, billing histories, reminders about client preferences, notes about plans for future products and services to be purchased, and any unique and novel information concerning the customer.
- Use a process to obtain and maintain the information that goes beyond basic information gathering. Preserve any information concerning the marketing methods used to build a client list as well as the success rate of those methods.
- Maintain records of the expenses incurred in creating and maintaining the customer list. By having a record of the expense and effort that go into building a client list, you will be in a better position to protect your list as a trade secret.
- Communicate to all employees the secret nature of client information and grant access only to employees who require that information to perform their job functions. Your employee manual and new employee training should emphasize that this information is confidential and the company expects its employees to maintain that confidentiality.
- Require non-employees to sign an acknowledgement of confidentiality before you give them access to your customer list.

These steps provide only a starting point for protecting your customer list. Creating a written plan that maximizes that protection should be the result of a well-thought-out process that reflects the nature of your industry and competition, the unique characteristics of your company, and the input of a legal advisor who is experienced in protecting trade secrets and other confidential information. ■

Restrictive Covenants in Arizona Employment Agreements

To stand up in Arizona courts, restrictive covenants must be reasonable, narrowly tailored, and allow a former employee to work in their chosen field.

DENIS FITZGIBBONS

A RESTRICTIVE COVENANT IS AN AGREEMENT whereby an employee agrees to forego engaging in certain competitive conduct with the company for a specified period of time and within a set location. Restrictive covenants are used to protect the company's legitimate business interests and prevent unfair competition.

In a 2013 decision, the Arizona Court of Appeals made clear that companies who overreach, with overly broad restrictions, may be unable to enforce their restrictive covenants. In *Orca Communications Unlimited, LLC v. Noder*, the Court ruled that, to be enforceable, restrictive covenants must be precisely drafted, and that failure to do so will have significant consequences for the company.

Orca v. Noder involved the departing president (Ms. Noder) of a public relations firm (Orca Communications). During her employment, Ms. Noder signed a confidentiality, non-solicitation and non-competition agreement. The agreement prohibited her from:

- using Orca's confidential information or disclosing it to third parties;
- providing conflicting services;
- soliciting any of Orca's clients or potential clients; and
- hiring Orca employees after she left employment.

Before leaving Orca, Ms. Noder informed potential clients that she was planning to start her own firm. After she left, Orca sued her for, among other things, breaching their agreement. In her defense, she argued that the restrictive covenants were overly broad and should not be enforced against her.

The trial court agreed with Ms. Noder and dismissed Orca's complaint. The Arizona Court of Appeals upheld the ruling, finding that the restrictive covenants were unenforceable because they were overly broad.

Guidelines for Employers

Orca v. Noder offers useful guidelines and limitations for employers in trying to restrict their employees' competitive activities.

Confidentiality. With regard to the confidentiality covenant, the Court's ruling reiterated the long-established principle that confidentiality agreements can protect information that is "truly confidential" and not generally known to the public. Orca's agreement, however, was found to be

not limited to "truly confidential" information; rather, Orca sought to limit Ms. Noder's ability to disclose information that was available publicly but only through "substantial searching of published literature" or had to be "pieced together" from public sources.

Also, Orca had defined as "confidential" any information that Ms. Noder came across during her employment and was not generally known and was "substantially inaccessible." The Court found that this overly broad definition made the confidentiality covenant unenforceable. Because its covenant included information that was not generally confidential, Orca could not enforce the confidentiality restriction at all.

Competition. Orca's non-competition and client non-solicitation covenants also were found to be overly broad under Arizona law, which holds that such provisions are enforceable only when they are narrowly drawn to protect the company's legitimate business interests.

The Court found that Orca's non-competition covenant did not meet the statutory requirement because it prohibited Ms. Noder from pursuing any type of work in the field and did not limit its reach *only* to Orca's protectable interest - i.e., confidential information and client relationships.

The client non-solicitation provision was also found unenforceable because it sought to protect not only actual client relationships but also "potential" relationships and those with Orca's *former* clients.

Enforceable Provisions

It is important for employers to understand that *Orca v. Noder* does not prohibit them from enforcing properly drawn confidentiality, non-competition or non-solicitation provisions in employment agreements. Rather, it reaffirms that restrictions on post-employment activities must:

- be reasonable;
- be narrowly tailored as to time and place; and
- not bar a former employee from making a living in their chosen field.

Orca v. Noder underscores the need for Arizona companies to review their particular facts before drafting a restrictive covenant in their employment agreements, to ensure that any covenants are narrowly tailored and will survive legal challenges in protecting the company's legitimate interests. ■



Arizona's New LLC Law Poses Traps for Unwary Members and Managers

If your operating agreement does not address certain issues, Arizona's new limited liability company law will impose default provisions that may not be to your liking.

DAVID A. FITZGIBBONS III

While this article does not directly pertain to employment law, the fact that the majority of Arizona employers are limited liability companies warrants its inclusion here.

IN 2018 THE ARIZONA LEGISLATURE PASSED, and Governor Ducey signed into law, wholesale changes to the essential structure of Arizona limited liability companies (LLCs). As a result, the relatively settled law concerning the treatment of LLCs in Arizona now becomes unsettled, and dark clouds lurk on the horizon.

By way of history, Arizona legislation that was passed in 1992 allowed for the creation of LLCs in our state. With minor changes, the law has served to govern Arizona LLCs fairly consistently for the last 25 years. The 2018 law calls for the phased-in repeal of the 1992 law and replacing it with an entirely new Arizona Limited Liability Company Act (ALLCA). A number of states have adopted the Revised Uniform Limited Liability Company Act and, by enacting the ALLCA, Arizona joins the growing trend.

Key Dates

The new law imposes two important deadlines on Arizona LLCs to be ALLCA compliant:

- All LLCs formed in Arizona on or after September 1, 2019, must comply with the ALLCA.
- On September 1, 2020, the 1992 law will expire, and all Arizona LLCs, regardless of their date of formation, must be ALLCA compliant.

Because of the wholesale repeal of the 1992 law and its replacement with the 2018 law, LLC members and managers are strongly urged to initiate a review of their LLC – specifically, its operating agreement – to verify that the LLC is ALLCA compliant and will avoid any unwanted default provisions that the ALLCA will automatically impose come September 1, 2020.

The new law primarily affects LLCs with multiple members. However, in some circumstances, a single-member LLC could be adversely impacted by the new law.

A full discussion of the significant changes is not covered here. Out of necessity, a proper analysis of your LLC



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will be fact-specific and focus on the particular provisions of your operating agreement, if it exists. The 1992 law generally does not require LLCs to have an operating agreement; if your LLC does not have an operating agreement, the 2018 law effectively imposes one on your LLC, and the default provisions may not be to your liking.

It is important to note that, under the new law, your operating agreement does not have to mirror the ALLCA's provisions. Rather, your agreement should address the subjects of those provisions and define them in ways that are appropriate for your LLC.

Highlights

For general discussion purposes, it is helpful to highlight a few of the significant ALLCA changes affecting Arizona LLCs:

- **Contributions.** Under ALLCA, a person's obligation to make a contribution to the LLC is not enforceable unless it is in writing, and it is not excused by death, disability or termination.
- **Fiduciary Duties.** Under the ALLCA, a member of a member-managed LLC will owe the company and other members a duty of loyalty and should act in a

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Labor Department Announces New Overtime Exemption Rules

Effective January 1, 2020, the U.S. Department of Labor has imposed a 50% hike in the minimum salary requirement for administrative workers to be exempt from overtime pay.

DENIS FITZGIBBONS AND TINA VANNUCCI

WHETHER WORKERS ARE EXEMPT FROM OVERTIME or non-exempt depends, in part, on their duties. Executive, administrative and professional employees are generally considered exempt. However, in addition to satisfying the "duties test," to be exempt under current rules the employee must be paid a salary of at least \$23,660 a year (\$455/week).

That will change January 1, 2020, when the minimum required salary for overtime-exempt employees will increase by nearly 50%, to \$35,568 per year (\$684/week), and many employees who are currently exempt may soon be entitled to overtime pay. The Labor Department estimates that the increase will make 1.3 million additional American workers eligible for overtime.

Example. You pay an exempt administrative employee a \$500 weekly salary. In an average week, that employee works 50 hours. Under the new rules, that employee's \$500 weekly salary will be \$184 below the \$684 weekly minimum to qualify for the overtime exemption and would become eligible for overtime pay. If the employee continues to work 50 hours a week at \$12.50/hour (\$500 divided by 40 hours), that employee will be entitled to 10 hours of overtime pay at \$18.75/hour, raising their weekly pay to \$687.50.

Plan Ahead

To prepare for this change:

- Determine whether employees treated as exempt, based on their job description and duties, really are exempt. If they do not satisfy the duties test, change their status to non-exempt.
- If an employee meets the duties test but is not close to the new salary minimum, consider whether you will raise their pay so they will continue to be exempt. If the employee does not regularly work more than 40 hours a week, it may be less expensive to pay overtime rather than increase their pay rate.
- For a currently exempt employee who works a lot of hours but whose base weekly salary is less than \$684, determine whether to lower their hourly rate so that, with overtime, they will continue to earn roughly the current amount.
- Be more diligent in limiting overtime and determine which employees can be capped at 40 hours.
- To avoid excessive overtime, consider adding full- or part-time employees. ■

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manner consistent with a contractual obligation of good faith and fair dealing.

Similarly, the manager of a manager-managed LLC will owe the company and its members a duty of loyalty and must discharge his duties and obligations under the ALLCA with a contractual obligation of good faith and fair dealing.

In June 2019, the Arizona Supreme Court ruled, in *In re Sky Harbor Properties, LLC v. Patel Properties, LLC*, that a fiduciary duty already exists in Arizona LLCs.

• **Distributions Before Dissolution.** The ALLCA provides a new requirement that all distributions made before an LLC can dissolve and wind up must be "equal among members," regardless of ownership percentages. This particular provision could have significant financial and tax ramifications to members, especially majority members.

Other ALLCA provisions that impose changes to the way Arizona LLCs transact business include:

- records and records inspection
- agency liability
- personal liability
- appraisal rights
- professional limited liability companies.

Silver Lining

The silver lining to these dark clouds is a provision in the ALLCA that allows an LLC's operating agreement to contain provisions to avoid the ALLCA's potentially harsh effects. As a result, a review of your LLC operating agreement warrants your prompt attention. ■

To schedule a review of your LLC's operating agreement, call David Fitzgibbons or Tina Vannucci at 520-426-3824.

The Basics of Mandatory Paid Sick Leave

All employers are subject to the Arizona law that provides for a minimum accrual of one hour of paid sick leave for every 30 hours worked, up to the statutory limits.

DENIS FITZGIBBONS

WHEN ARIZONA VOTERS PASSED PROPOSITION 206 in 2016, much of the attention was focused on increasing the state's minimum wage to \$10 per hour. However, of greater concern to many employers has been Prop. 206's other provision: *mandatory paid sick leave*.

Effective July 1, 2017, employees of small employers (under 15 employees, including part-time and temporary workers) are eligible for 24 hours of sick leave per year; at larger employers, the requirement is 40 hours.

All employers are subject to the law (A.R.S. § 23-372), which provides for a minimum accrual of one hour of leave for every 30 hours worked, up to the limits noted above. Accrual starts with the first day of employment or July 1, 2017, whichever occurred later. Employers can have policies restricting employees from using leave within the first 90 days of employment.

If an employer is already providing enough paid time off to cover the minimum amount of paid sick time, and if the employer allows its workers to use that time off in the same way as paid sick leave, then the employer does not need to provide additional paid sick time.

Employees are allowed to use their accrued paid sick leave for their own illness and for the illnesses of family members. At the end of a year, any unused paid sick leave carries over to the next year, unless the employer chooses to pay them for their unused sick time. (Any unused leave does not need to be paid out when the employee resigns or is terminated.)

Employers that want to require employees to provide notice prior to taking foreseeable leave must have a written policy that spells out how the notice is to be given.

Employers may not retaliate against employees for using or requesting paid sick leave. The law provides that, if any discipline occurs to an employee within 90 days of them taking sick leave, there is a presumption that the discipline is retaliatory.

Failure to Comply. The first violation carries a minimum \$250 fine; for each subsequent violation, the fine is a minimum \$1,000. Also, non-compliant employers must pay the employee the unpaid balance of the earned paid sick leave owed, plus interest, plus an additional amount equal to twice the unpaid sick leave.

Employers should ensure that employee handbooks and policies are consistent with the law and that their payroll systems are able to track the accrual and payment of sick leave. ■

Can You Require a Doctor's Note from a Sick Employee?

NICK COOK

Missing time from work due to illness is not only unpleasant for the employee; it can also be disruptive and expensive for his or her employer. Nonetheless, there are limits on what an employer may require from an employee prior to approving their use of earned sick leave or before the employee returns to work.

Employers covered by Arizona law requiring paid sick leave accrual are required to allow employees to accrue earned sick time at a rate of 1-to-30, meaning the employee accrues one hour of paid sick leave for every 30 hours of work they perform. The employee, however, may not accrue more than 40 hours of paid sick leave per year, unless the employer allows a higher limit.

Paid Sick Leave Protections

When an employee uses their paid sick leave, they are granted certain protections. Most notably, when an employee takes earned sick leave for a period of less than three consecutive days, their employer cannot require the employee to prove that the paid sick leave was used for a "covered purpose" - e.g., mental or physical illness, injury or health condition, and the need for medical diagnosis of those conditions. Further covered is the present or preventive care for any family member with a condition.

The rules change when earned sick leave is used for three or more consecutive days. In such a case, employers can require reasonable documentation establishing that the time was used properly. In no scenario, though, may an employer require documentation describing or establishing the nature of a health condition. In many situations, reasonable documentation may be established by providing a document signed by a health care professional indicating that the paid sick leave was necessary.

Both employers and employees should note the fine line that, when the paid sick leave covers less than three straight days, separates "requesting" documentation and "requiring" it. The law does not bar an employer from requesting reasonable documentation; employees are simply not required to provide it. Thus, if an employee uses paid sick leave for only one day, they may be asked to provide documentation, but complying with that request is not a condition for approving the paid sick leave. ■



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