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NLRB Challenges Confidentiality Instructions During Investigations Into Employee Misconduct

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***Employer Update* has moved to a new publication schedule.**

Employer Update will now be published monthly, with one or two articles per edition. This more frequent publication schedule will allow for more timely updates about developments in employment and labor law and other issues affecting the workplace. As always, please contact any of the authors or your contact at Weil for more information.

When companies conduct internal investigations into alleged employee misconduct, witnesses being interviewed are routinely instructed to maintain confidentiality of their knowledge of and participation in the investigations. The obvious reasons for maintaining confidentiality include: to encourage witnesses to participate in company investigations, to protect witnesses from possible retaliation, to increase the likelihood that witnesses will accurately describe the facts, and to promote a fair and impartial process. Without the ability to protect the integrity of an investigation, employers have greater difficulty in verifying and remediating workplace misconduct. Despite precedent which recognized the importance of maintaining the confidentiality of company investigations into employee misconduct,[1] the National Labor Relations Board (NLRB) in two recent decisions, *Hyundai America Shipping Agency, Inc.*, 357 N.L.R.B. No. 80 (2011) and *Banner Health System*, 358 N.L.R.B. No. 93 (2012), continued its trend of challenging long-accepted practices by employers.[2] In *Hyundai* and *Banner Health*, the NLRB upended the careful balance which existed between the confidentiality expected by employers conducting investigations into employee misconduct and the rights of workers to discuss such investigations with co-workers under Section 7 of the National Labor Relations Act (NLRA).

On July 30, 2012, in *Banner Health System*, the NLRB found that an employer's "generalized concern" with protecting the integrity of investigations into employee misconduct does not outweigh employees' Section 7 rights to discuss such investigations. The two-member majority of the panel held that for an employer lawfully to instruct its employees not to discuss investigations involving employee misconduct, the employer must *first* determine whether "witnesses needed protection, evidence was in danger of being destroyed, testimony was in danger of being fabricated, or there was a need to prevent a cover up." *Banner Health System,* 358 N.L.R.B. No. 93, 2012 WL 3095606, at *2.[3] Additionally, the panel held that an employer's mere "instruction" – without the threat of punishment – to employees not to discuss an investigation constituted an unlawful restraint of Section 7 rights. In this article, we analyze *Banner Health* and recommend steps employers should consider in assessing their practices for conducting internal investigations.

Background

Section 7 of the National Labor Relations Act creates a right for private-sector employees who are covered by the NLRA,[4] whether unionized or not, "to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection." National Labor Relations Act § 7, 29 U.S.C. § 157 (2006). Section 8 of the NLRA provides that "it shall be an unfair labor practice for an employer – to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in Section 7." 29 U.S.C. § 158 (2006).

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Section 7 provides employees a right to "discuss discipline or disciplinary investigations involving fellow employees." *Caesar's Palace*, 336 N.L.R.B. 271, 272 (2001). However, as the NLRB has long recognized, an employer's rule prohibiting discussion by employees of an ongoing investigation is not necessarily unlawful and unenforceable. Only where an employee's interest in discussing the investigation outweighs the employer's asserted justification in maintaining the investigation's confidentiality will a violation of a Section 7 right exist. Conversely, where an employer's "legitimate and substantial business justification" outweighs the employee's interests in discussing the investigation, there is no violation. *Id.* (citing *Jeannette Corp. v. NLRB*, 532 F.2d 916 (3d Cir. 1976)). A "legitimate and substantial business justification" exists where confidentiality is necessary "to ensure that witnesses were not put in danger, that evidence was not destroyed, and testimony was not fabricated." *Caesar's Palace*, 336 N.L.R.B. at 272. It is the NLRB's responsibility to strike the proper balance between the asserted business justifications and the invastion of employee rights in light of the act and its policy. *Caesar's Palace*, 336 N.L.R.B. at 272 n.6.

Hyundai America

In *Hyundai America Shipping Agency, Inc.*, Human Resources personnel routinely provided an oral caution to employees involved in investigations, not to talk with other employees about the substance of those investigations. On August 26, 2011, the NLRB affirmed an Administrative Law Judge's (ALJ) decision that held that these "routine" instructions violated Section 8(a)(1) of the NLRA. The ALJ in *Hyundai* found that "under the Board's balancing test it is the [employer's] responsibility to first determine whether in any give[n] investigation witnesses need protection, evidence is in danger of being destroyed, testimony is in danger of being fabricated and there is a need to prevent a cover up." *Hyundai Am. Shipping Agency, Inc.*, 357 N.L.R.B. No. 80, 2011 WL 4830117, at *27 (Oct. 18, 2010). The NLRB affirmed the ALJ's finding that an oral rule at issue in *Hyundai* had violated Section 8(a)(1), *Hyundai*, 2011 WL 4830117, at *1, but the NLRB did not explicitly agree with the ALJ's finding that the employer must engage in a preliminary analysis every time an investigation into employee misconduct is commenced.

Banner Health

In *Banner Health*, James Navarro, a hospital sterile technician responsible for the proper care of the hospital's surgical instruments, was required by hospital policy to sterilize surgical equipment using hot water and steam pressure. When steam pressure was unavailable one day as a result of a broken steam pipe, Mr. Navarro was directed by his supervisor to use a Sterrad machine – a low temperature sterilizer that uses hydrogen peroxide as the sterilant – to sterilize the equipment instead of hot water. Mr. Navarro could find no information permitting such a sterilization process and therefore refused to comply with his supervisor's directive. When Mr. Navarro's supervisor learned that Navarro was not following directions, the supervisor chastised him. The employer's Human Resources department commenced an investigation into the propriety of Mr. Navarro's refusal to obey orders. Mr. Navarro was asked by Human Resources not to discuss the ongoing investigation with colleagues. Despite this instruction, Mr. Navarro spoke to several of his coworkers about the investigation. Ultimately, Mr. Navarro was punished with a "coaching" for not sterilizing the equipment as directed.

On April 7, 2011, Mr. Navarro filed a charge with the NLRB alleging that his employer had violated Section 8(a)(1) of the NLRA by instructing him not to discuss the investigation with his colleagues. On June 30, 2011, the NLRB's Office of General Counsel issued a complaint against the employer on the same grounds.

On October 31, 2011, Administrative Law Judge Jay R. Pollack determined that the employer's instruction to Navarro to maintain the confidentiality of the investigation did not violate Section 8(a)(1) of the NLRA. The ALJ found that the employer's "legitimate business reason" for requesting confidentiality outweighed Navarro's Section 7 rights.

On July 31, 2012, the NLRB disagreed with the ALJ's finding that the employer's confidentiality instruction did not violate Navarro's Section 7 rights. Noting that the Human Resources department "routinely" asked employees making a complaint to keep matters confidential, the NLRB determined that the employer had violated Section 8. The NLRB explained that the employer's:

> generalized concern with protecting the integrity of its investigations is insufficient to outweigh employees' Section 7 rights. Rather, in order to minimize the impact on Section 7 rights, it [is] the Respondent's burden to first determine whether in any given investigation witnesses needed protection, evidence was in danger of being destroyed, testimony was in danger of being fabricated, or there was a need to prevent a cover up. The Respondent's blanket approach clearly failed to meet those requirements.

Banner Health System, Inc., 358 N.L.R.B. No. 93, 2012 WL 3095606, at *2.

An employer's generalized concern with protecting the integrity of its investigations is insufficient to outweigh employees' Section 7 rights.

The Board noted that although Navarro was not threatened with discipline if he violated the confidentiality instruction, the law "does not require that a rule contain a direct or specific threat of discipline in order to be found unlawful," and such instruction is an unlawful restraint of Section 7 rights if when "viewed in context it ha[s] a reasonable tendency to coerce employees." *Id.*

Practice Pointers

Following *Banner Health*, employers should review their current policies, practices and procedures to ascertain whether they contain blanket provisions instructing or even requesting that employees not share confidential information concerning ongoing investigations into employee misconduct with other employees. Employers should re-evaluate whether any changes to the language of their policies and procedures are necessary. In particular, employers should examine guidelines or intake forms that may be used in conducting internal investigations. If those materials direct the interviewer to instruct (or request), as a matter of protocol or routine, that the employee not discuss the investigation, an employee could argue that such an instruction violates Section 8(a)(1). Indeed, even where an employer has determined that the integrity of a specific investigation is at risk, the existence of a standard protocol or procedure instructing employees not to discuss any investigation runs the risk of causing the NLRB to find a NLRA violation.

One suggestion for employer compliance with *Banner Health* is for the investigator to wait until after at least one employee is interviewed to give any instruction regarding confidentiality. To the extent possible and consistent with the goals of the investigation, a supervisor who is not covered by the NLRA should be interviewed first, before non-supervisors. Following the interview, if the witness's remarks create a factual basis from which the investigator believes that the investigation would be susceptible to influence, evidence is in danger of being destroyed, testimony is in danger of being fabricated, or witnesses may be in danger of retaliation, the interviewer may have the necessary factual basis allowing the employer to instruct the initial witness, and potentially future witnesses, that they should not share information about the investigation with any of their co-workers. As a best practice, the interviewer may wish to confirm this instruction in a memorandum to the file. The memorandum also might include a statement that the interviewer informed the witness not to share information concerning the investigation because the interviewer became concerned that the investigation might become tainted and facts might be influenced, and the basis for such concerns from the witness's remarks.

1 *See*, *e.g.*, *N. Ind. Public Serv. Co.*, 347 N.L.R.B. 210, 212 (2006); *Pennsylvania Power Co.*, 301 N.L.R.B. 1104, 1107 (1991).

2 *See*, *e.g.*, *NLRB v. Am. Red Cross*, 2012 WL 311334 (N.L.R.B. Feb. 1, 2012) (finding employment-at-will provision in violation of Section 8(a)(1) of the NLRA); Jeffrey S. Klein & Nicholas J. Pappas, "Arbitration and Class Action Waivers After *Concepcion* and *Horton*," *New York Law Journal*, April 2, 2012 (discussing *D.R. Horton Inc.*, 2012 WL 36274 (N.L.R.B. Jan. 3, 2012), which invalidated an agreement requiring all employees individually to arbitrate employment claims); *Sodexo Am. LLC*, 358 N.L.R.B. No. 79 (2012) and *Saint John's Health Ctr*, 357 N.L.R.B. No. 170 (2011) (finding off-duty no-access policies in violation of NLRA protections); Jeffrey S. Klein & Nicholas J. Pappas, "Social Media Policies Violate Employees' NLRA Section 7 Rights," *New York Law Journal*, October 3, 2011 (discussing an August 18, 2011 report issued by the Office of the General Counsel of the NLRB asserting that certain policies prohibiting harassing or other offensive communications may violate Section 8(a)(1)). Since *Banner Health* was decided in July 2012, the NLRB has further continued to challenge employers' long-standing practices. *See*, *e.g.*, *Karl Knauz Motors, Inc.*, 358 N.L.R.B. No. 164 (Sep. 28, 2012) (finding in violation of Section 8(a)(1) a "courtesy rule" instructing employees not to be "disrespectful or use profanity or any other language which injures the image or reputation of [the employer]"); *EchoStar Techs. LLC*, No. 27-CA-066726, 2012 WL 4321039 (N.L.R.B. Div. of Judges, Sep. 20, 2012) (finding in violation of Section 8(a)(1) a provision in an employer's social media policy prohibiting employees from making "disparaging or defamatory comments about [the employer]" on social media sites).

3 The appointments of the Members forming the majority, Members Block and Griffin, are currently being challenged before the Seventh Circuit as being unconstitutional "recess" appointments because they were made while the Senate was technically still in session. *See Richards v. NLRB*, No. 12-1973 (7th Cir. filed Apr. 23, 2012) (petition for review of *United Steel Allied Indus. and Serv. Workers*, 357 N.L.R.B. No. 48 (Aug. 16, 2011) and *United Steel Allied Indus. and Serv. Workers*, 2012 WL 1312894 (N.L.R.B.) (Apr. 18, 2012)).

4 The NLRA does not apply to supervisors, agricultural laborers, domestic servants, children or spouses of the employer, independent contractors, supervisors, and employees of persons who are not "employers" under the NLRA. 29 U.S.C. § 152 (2006). Also excluded are railroad and airline employees, because they are protected instead by the National Mediation Board under the Railway Labor Act. *Id.*; *see* 45 U.S.C. §151, *et seq.* (2006).

In Noncompetes, Substance Matters

By Christopher J. Cox and Gregory D. Hull

In *Edwards v. Arthur Andersen*, 44 Cal.4th 937 (2008), the California Supreme Court held that covenants not to compete, even if narrowly drawn, are invalid and unenforceable under California Business & Professions Code §16600 unless the covenant falls within one of three statutory exceptions. One of those exceptions is found in §16601, which permits such restrictive covenants in connection with the sale of a business. In *Fillpoint v. Maas*, 208 Cal.App.4th 1170 (2012), California's Fourth District Court of Appeal reaffirmed that noncompete agreements, even if generally associated with the sale of a business, are not enforceable in California unless they are specifically tailored to protect the value of the acquired business. *Fillpoint* helps define the boundary between enforceable restrictive covenants which legitimately protect the goodwill of a business and unenforceable covenants which restrict employee mobility beyond the narrow exception permitted under §16601. Although the opinion does not create new law, it should be required reading for those drafting such covenants in anticipation of a merger or acquisition of a business.

In *Fillpoint*, Michael Maas owned stock in his employer's parent company and signed a securities purchase agreement upon the sale of that company. The purchase agreement contained a three-year covenant not to compete in the relevant business of distributing and publishing video games. The term was three years from the close of the transaction. About one month later, Maas signed a three-year employment agreement, which restricted competing conduct (contacting customers, working for a direct competitor or soliciting workers) for one year post-employment. Three years after signing the agreements, thus satisfying the noncompete term in the purchase agreement and employment term in the employment agreement, Maas resigned and became the president, chief executive officer and major shareholder of a competing company. Fillpoint (an assignee of rights in the employment agreement) then sued Maas for breach of the employment agreement and Maas asserted a defense that the covenant was an unenforceable restraint of trade under §16600. Following plaintiff's opening statement and briefing on the issue, the trial court granted Maas' motion for nonsuit on the grounds that the employment agreement and purchase agreement were "separate" and the noncompete in the employment agreement was unenforceable under §16600.

On appeal, the court first addressed whether the two agreements should be read together or as separate and independent agreements. The court found that the two agreements were in fact part of the same transaction and should be read together as an integrated agreement. Although the court found that the trial court erred in concluding that the purchase agreement and employment agreement must be read separately, it rejected Fillpoint's contention that it should necessarily follow that the restrictive covenant in the employment agreement was enforceable. The finding that the purchase agreement and the employment agreement must be read together "begins, not ends, the analysis."

The court discussed some basic principles which inform whether a particular covenant will be enforceable under §16601. An enforceable covenant need not be located in a particular transactional document, e.g., in the purchase agreement itself, to be enforceable under §16601. However, regardless of where it is found, the words and phrases of the covenant must evidence an intent to protect "the acquired goodwill" associated with the asset or business purchased. The covenant must also be narrowly drawn so that it does not restrict competition beyond that necessary to protect the purchaser's interest in the acquired asset.

Based on application of these principles, the court found that the covenant contained in the employment agreement did not fall within the narrow exception of §16601, but instead "targeted an employee's fundamental right to pursue his or her profession" in violation of §16600. Fillpoint conceded in its opening brief that the covenants in the purchase agreement and employment agreement were intended "to deal with the different damage Maas might do wearing the separate hats of a major shareholder and key employee." Restricting Maas' ability to compete because he was a "key employee" crossed the line and could not "be reconciled with California's strong public policy permitting employees the right to pursue a lawful occupation of their own choice."

The fact that the unenforceable covenant was tied to the end of employment, and not to the closing of the transaction, also showed that the purpose of the noncompete was to restrict Maas' mobility as an employee, rather than to protect the acquired goodwill of the business. The tying of the three-year noncompete term in the purchase agreement to the closing of the deal further supported this finding.

Further, the nonsolicit terms of the employment agreement covenant "even barred sales to or solicitation of potential customers." This language is inconsistent with the purposes underlying Business & Professions Code §§16600 and

16601 because the covenants "do more than ensure the buyer receives the full value of the business it bought," whose "goodwill does not include the patronage of the general public." The covenants here would give the buyer broad protection against competition wherever it happens to have employees or customers, at the expense of the seller's fundamental right to compete for employees and customers in the marketplace."

The primary takeaway from *Fillpoint* is that California noncompetes associated with the purchase of a business must be tethered to protection of the acquired assets/goodwill and restrictive covenants — even those within the integrated sales agreements — are at risk of being voided if the restrictions go beyond the limited exception of §16601.

For the practitioner, there are several practical considerations raised by this opinion.

Placing a covenant into the seminal transfer documents will not ensure that the covenant will be enforceable under §16601. *Fillpoint* makes crystal clear that the central inquiry under §16601 is not where the covenant is located, but whether the words and phrases of the covenant evidence an intent to protect the goodwill of the business/asset purchased. In addition to including such language, tying the term (here three years) to the closing of the transaction, rather than a term of employment, will be easier to defend if challenged.

Even if the covenant is drafted to evidence an intent to restrict competition as a means for protecting the acquired goodwill of a business, it must be narrowly tailored to protect only that goodwill. Thus, for example, covenants that bar the seller from soliciting all customers of the buyer, or all employees, even those who were neither customers nor employees at the time of the acquisition are overinclusive and may fall outside the protections afforded by §16601.

A last word to the wise: A practitioner should not rely on the court to simply narrow an otherwise broad covenant not to compete. In the strictest sense, "blue penciling" refers to striking provisions of restrictive covenants which violate the law, while allowing other provisions to stand. The general rule in California is straightforward — our courts will not rewrite an illegal covenant not to compete because the policy behind §16600 would be undermined by such a judicial practice. According to California jurisprudence, use of the "blue pencil" in this way would simply incent employers to use very broad, illegal covenants secure in the belief that if pressed on such a covenant a court would rewrite it to conform to the law. Thus, a practitioner should not expect courts applying California law to prune away overinclusive words and phrases to save an otherwise unenforceable covenant. Get it right the first time.

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