

Navigating The Thicket Of Non-Compete Agreements

By Joseph C. Dole
and Christian P. Jones

Non-compete agreements (also known as covenants not to compete or restrictive covenants) come in a variety of shapes and sizes and are more important today than ever before.

The more competitive a particular industry, the more likely it is that such covenants are used in that industry for executives and management employees who possess confidential information about their employer's products,

VIEWPOINT

pricing structure, and strategic plans, and for sales employees who have developed important relationships with customers.

Although the use of covenants today is ever more prevalent, restrictive covenants continue to pose problems for both the employer who seeks to protect his own confidential information and customer contacts, and for the employer who wants to hire a competitor's employee.

■ **Enforceability generally.** The typical non-compete agreement restricts the employee's ability to work for a competitor, prohibits the employee from dis-

closing confidential information, and often prohibits the employee from soliciting co-employees to leave the employer.

Non-solicitation of co-employees provisions are generally enforceable as long as there is consideration for the promise. Confidentiality provisions are enforceable with respect to information that qualifies as protectable trade secrets, but not public information.

The more difficult questions regarding enforceability center around the actual covenant not to compete, including provisions which bar solicitation of customers.

Whether the covenant is enforceable turns first on whether the employer seeking to enforce the covenant has a legally protectable interest. Other legal considerations include the length of the restriction, the geographic scope of the restriction, and the nature of the restriction — all of which must be reasonable.

■ **Maximizing enforceability of the non-compete.** The employer that has legally cognizable interests to protect can take several steps to maximize the chances that the covenant will be deemed enforceable in the face of likely judicial hostility.

■ **One size does not fit all.** Many employers use the same restrictive covenant regardless of the position held by the employee and regardless of what information that employee may possess.

The chances a covenant will be deemed enforceable will increase if each covenant is tailored to a particular employee or at least a particular type of position.

■ **Adequate consideration.** Make sure that continued employment is adequate consideration for the employee's promise not to compete.

It is unlikely that a court would find that continued employment was adequate consideration when an employee was required to sign a covenant shortly before being discharged. On a related note, courts are often more receptive to enforcing the covenant if the covenant provides the employee with salary continuation in the event of involuntary discharge.

■ **Make the covenant reasonable.** Prohibiting an employee from working in any capacity for

a broad range of companies anywhere in the world for 10 years is not likely to be viewed as reasonable, and is likely to make the court hostile to enforcement generally. While courts in many states will redraw the restrictions to make them reasonable, the court may not redraw them the way an employer wants them redrawn.



Dole



Jones

For both reasons, it is wiser to make the time, geographic area, and activities restricted reasonable from the start. Consider carefully the length of time needed to eliminate the threat of competition from a departing employee. If you conclude that a six-month hiatus is likely to

be sufficient to introduce a new sales representative to the customers and to develop the necessary relationship to avoid losing the business, do not draft a covenant that restricts the employee for three years.

Consider carefully what harm you are guarding against. If there are only two significant competitors with respect to the product the employee sold, limit the

non-competition clause to those competitors and any successors or affiliates, rather than drafting a covenant which restricts the employee from working for all of the company's competitors.

Similarly, if the employee's sales territory was New York and New Jersey, limit the covenant to those territories, or better yet, to the customers the employee called on in those territories, rather than prohibiting him from selling anywhere in the Northeast or nationally.

Again, this makes the employer, as the party who is trying to restrict the individual's ability to earn a living, seem reasonable, and enhances the likelihood that a court will view the restrictions as fair restrictions on the individual's ability to earn a living.

■ **The departing employee.** When an employee is terminating employment, whether voluntarily or involuntarily, remind the employee of his obligations. This can be done most effectively in writing and by providing the employee with a copy of any applicable agreements before he leaves.

Reminding the employee of the obligations may be enough to

See **COMPETE**, page 14 ►

COMPETE: *Make the restricted time frame, region reasonable from the start*

▼ Continued from page 12

dissuade the employee from working for a competitor. It may also serve to flush out the employee's future plans, and if it does not, it never hurts to ask.

Knowing the identity of the future employer early will enable you to deal with potential violation of the covenants early on by contacting the future employer, if necessary.

If a departing employee does not have a covenant not to compete, termination can be an appropriate time to obtain one if the employee is willing to sign one in ex-

change for a valuable consideration, such as severance or enhanced severance.

■ **The incoming employee.** Many employers have experienced a situation where a newly hired employee brings with him an unwanted restrictive covenant.

Sometimes the new hire is forthcoming about the existence of the restriction. Other times the employers only learn of it when they receive a letter from the former employer's attorney.

If an employee breaches an enforceable covenant with his previous employer, the new employer can be held liable in some circumstances for the former employer's

lost profits. There are certain steps an employer can take, however, to avoid or minimize the risk of liability.

■ **What if a covenant does exist?** If the employee discloses the existence of a covenant, or the employer discovers after an offer has been made that a covenant exists, the employer needs to carefully analyze the legal risk, the employee's value to the organization, and whether it can live with the covenant until it expires.

In assessing whether to hire or to retain an individual who has a restrictive covenant, the lowest risk option is normally to not hire or to withdraw an offer. Of course,

this may result in the loss of a valuable asset.

Alternatively, the new employer should assess the likely enforceability of the covenant, the likelihood the former employer will sue to enforce it, and the potential damages of a successful action.

If those potential risks and consequences are small, they may be risks worth taking, depending upon the value of the new hire.

A lower-risk approach is to determine whether the new employee can provide value if he works within the structures of the covenant, or the terms of the covenant which are most likely to be enforceable.

Conclusion

An employer needs to be realistic in evaluating the enforceability of a particular covenant with respect to a particular employee. Because of the tremendous uncertainty involved in the enforcement of non-competes, employers who use them should be taking actions, both with respect to drafting and otherwise, to maximize the chances of enforceability.

Employers hiring workers who have such covenants with their previous employers should take steps to minimize the risk that they will be held liable if the employee breaches an enforceable covenant.

Joseph C. Dole and Christian P. Jones are attorneys with Mackerzie Hughes LLP, who handle labor and employment legal issues. Contact Dole at (315) 233-8217 and contact Jones at (315) 233-8285.