



**Developments in
Noncompete/Trade
Secret and Restrictive
Covenant Law**

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**Most Common Types of
Restrictive Covenants**

- Prohibit employment in job that competes with former ER's business
- Prohibit solicitation of customers
- Prohibit raiding of EEs
- Prevent disclosure of confidential information
- Protect ownership by ER of EE's inventions and developments



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Importance in Today's Economy

- Protection of relationships with customers
- Protection of investment in training EEs
 - For non-portable skills and information
- Protection of customer identities and preferences
- Protection of trade secrets



Myths, Truths and Realities about Noncompetes

- Many sophisticated EEs believe Noncompetes are unenforceable
- Many EEs “forget” that they signed a Noncompete
- Many EEs sign documents without reading or understanding them
- Many ER practices perpetuate the above problems
- Many ERs shocked to find agreements unenforceable
 - Common unrealistic view of position
- Judges don't like to put people out of work
- Does not matter if termination involuntary



Key Legal Principles

Restrictive covenants are generally enforceable in Mass. if used thoughtfully

Restrictive covenants are subject to the highest level of judicial scrutiny

Fairness of ultimate result is critical

- Courts seek to balance between ER's and EE's interests

Courts regularly refuse to enforce the clear and unambiguous terms of restrictive covenants



What can Employers protect with restrictive covenants?

“Legitimate business interests”

- Confidential information
- Goodwill

Restrictive covenants cannot be used to protect against “ordinary competition”



What is “confidential information”?

Trade secrets
Business plans/new product development
Marketing/sales plan strategies
Intellectual property
Software designs
Financial and sales information
Customer preferences
Information that your company expends resources to obtain that give you a competitive advantage in the marketplace



Prior to Hiring an Employee

Which type of restrictive covenant (if any) is appropriate?

- Prohibit employment in job that competes with former ER's business
- Prohibit solicitation of customers
- Prohibit raiding of former co-workers
- Prevent disclosure of confidential information
- Protect ownership by ER of EE's inventions and developments



Pre-Hire (con't)

Avoid boilerplate

Tailor restrictive covenants to job and job duties

- National Engineering Service Corp. v. Grogan
 - » Non-compete tailored to recruiting industry
 - » Recruiter's only experience was at ER

Inform new hires that signing a non-compete is a condition of employment – no surprises

Address existence of non-competes with prior ER

- Employment application
- Offer letters
- Company policies
- Indemnification



During Employment

Identify trade secrets and take steps to ensure that information is truly “confidential”

- Bio-Imaging Technologies v. Marchant
 - » All EEs signed confidentiality agreement
 - » All bids subject to NDA

Review and update non-compete

- Change in job
- Change in territory/customers serviced
- Change in corporate structure



When an Employee Leaves

Conduct exit interview

Provide departing EE with a copy of applicable non-compete

Ask where they are going

- Deception matters

Consider letter to new ER

Consider language in a separation agreement

*** Secure return of company property and data

Obtain snapshot of email/system



Preparing to Compete

An EE preparing to go into competition may breach his fiduciary duty to his ER.

- No general duty to disclose plans to ER
- May not appropriate ER's trade secrets
- May not solicit customers while employed
- May not carry away customer lists
- May not use ER's resources for personal gain

Duty exists regardless of existence of non-compete

Investigate EE's conduct (and review/preserve EE's computer/e-mail) if you are suspicious of wrongdoing



Preparing to Compete (con't)

National Economic Research Associates, Inc. v. Evans (Gants, J)

- Economic consultant leaves position to head up division with competitor
- No breach of fiduciary duty because consultant
 - » Did not appropriate of trade secrets
 - » Did not bring with him list of clients
 - » Did not direct others to provide client list to new ER
 - » NERA never adopted policy that customer list was confidential
 - » *De minimus* use of computer systems and phones
 - NERA permitted EEs to use company laptops for personal use

M B J

A Competing Former Employee

Shot across bow letters

Move quickly!!!

Be willing to negotiate

Litigating restrictive covenants is time-intensive, fact-intensive process

To obtain injunctive relief, must show that ER is

- 1) it is likely to prevail on the merits of its claims;
- 2) it will suffer irreparable injury in the absence of injunctive relief;
- 3) the injury outweighs any harm which granting injunctive relief would inflict on opposing party; and
- 4) the public interest will be served by the issuance of the injunction.

M B J

What if no noncompete?

- ERs still have rights
- Law still protects trade secrets
- Duty of loyalty / fiduciary duty
- Non-interference with customer/business relationships, contracts
- Misappropriation of trade secrets



Strategies in absence of noncompete

- Sequester resigned EE
- Consider severance package with restrictions, enforce confidentiality
- Remind EE about important company policies (confidentiality, ethics, etc.)
- Inevitable disclosure doctrine
- Communicate directly with new ER about specific concerns
- Monitor important relationships, accounts, product launches



Trends

Increase in trade secret/restrictive covenant litigation

- from 2000-2009 the number of reported cases has doubled
- 1010 to 2366



Crossing State Lines

Former EE who moves out-of-state raises unique issues

Noncompete law varies state-to-state

- CA prohibits by statute
- GA very unfriendly
- Other states will strike entire agreement if overbroad
- Costly



Strategies for Dealing with the Border-Crosser

Call in the lawyers early

Sue first and ask questions later

Make sure contracts have key language:

- Secure home field advantage
- Choose Mass law
- Covenant not to litigate out-of-state
- Attorney fee payment for out-of-state litigation

Potential to box-in EE to foreign state



Indemnification of Former Employees

Beware of little known rules

- Del Code § 145

Company by-laws and state statutes provide protection to former EEs

- Typically to officers, but can be for lower level EEs as well

Companies may need to think twice before pursuing a former EE

- Potential to be required to pay attorneys' fees for defense



Dealing with California

Section 16600 of Cal Bus & Prof Code

- Prohibits noncompete agreements
- Exception: sale of business

Can still prohibit customer solicitation

Interesting angles:

- Can try to “box in” the former EE within CA
- Sign noncompete for other states



Mass Noncompete Bill

Codifies contractual procedure

\$75k minimum compensation

Consideration required during employment (10% or greater)

Length – 6 mos reasonable / >1 yr unreasonable

Fee shifting

Automatic tolling

Not retroactive



Other Noncompete Law Reform Measures

Illinois

- atty fee protection to EEs (if ER has provision)
- for key EEs only
- codifies contractual procedure
- presumed unreasonable if >1yr

Oregon

Idaho

Georgia

- move to become more favorable



To Do List Prior to New Law

Consider audit of restrictive covenant program

- Is program effective?
- Agreements narrowly tailored?

Consider whether modifications of agreements are necessary, and how close they are to new law

Review practices and policies



Material Changes May Nullify Prior Agreement

Lycos v. Jackson

Cypress Group v. Stride

EE's duties, responsibilities, direct reports, salary change and title changed over time.

“Material change” in employment relationship voids previously signed noncompete agreements.



THE END

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