

Ruling Provides Guidance on Restrictive Covenants

Labor & Employment Law Update

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Long used to prevent former employees from gaining an unfair competitive advantage, covenants not to compete are increasingly under attack. California, North Dakota and Oklahoma essentially ban employee non-competes and recent legislation in Illinois, Maine, Maryland, Massachusetts, New Hampshire, Oregon, and Washington prevents their use with lower wage employees (the definition of which varies by state). Some laws go further, in Massachusetts, for example, a non-compete cannot be enforced against an employee terminated without cause and, in many cases, the employer must pay 50% of the former employee's salary for the duration of the covenant.

In September, a federal court in Indiana struck down a non-compete as overly broad, but in an interesting twist, ordered the employee to cease work for a competitor because of his breach of the parties' confidentiality agreement. Like the majority of states, Indiana "disfavors" employee non-competes and will enforce them only when they are supported by adequate consideration and the restrictions imposed are "reasonable" in scope, time and geographic reach and are no greater than is necessary to protect the employer's legitimate interests.

The covenant in the Indiana case was deemed prohibitively broad in scope because it prevented the employee from working for a competitor "in any manner." The decision cautions employers to limit non-compete restrictions to competitive positions analogous to the work the employee actually performs. However, because the employee downloaded thousands of documents immediately before departing and shared at least some confidential information with his new employer, the court issued a preliminary injunction prohibiting the employee from continuing in his new role. His "pre-departure harvesting" of his former employer's confidential information warranted the injunction, the court concluded, because it created an "ongoing threat of potential or actual misappropriation" of his former employer's confidential information or trade secrets.

Restrictive covenants are tricky and one size does not fit all. So what steps can organizations take to protect themselves from unfair competition in today's highly competitive environment?

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- 1. Location matters.** Restrictive covenants are a matter of state law. Each agreement must meet the specific requirements of the jurisdiction where that employee's employment relationship is based. Include choice of law and forum selection clauses to streamline disputes.
- 2. Don't over reach.** Some positions warrant a true non-compete and for others an agreement not to solicit customers will suffice. Patent and copyright assignments are critical for some segments of the workforce but for many, the only real concern is ensuring a departing employee does not make use of confidential information or steal trade secrets. Focus on what you need to protect and tailor the agreement to meet those needs.
- 3. Safeguard confidential information.** A company's failure to adequately protect confidential information in its day to day operations can undercut the best confidentiality agreement.
- 4. Be upfront about restrictive covenants.** Waiting until after an employee accepts a position undercuts the consideration component and, in some jurisdictions, can invalidate an otherwise enforceable agreement. Ask prospective employees about ongoing contractual obligations before hiring them. Remind departing employees of ongoing contractual obligations.
- 5. Stay current.** Review your forms periodically. The law is constantly evolving in this area.