# Protecting Your US Business From Unfair Competition by Former Employees Requires Timely and Prudent Action

*By Scott J. Wenner*

The potential risks posed to a business by former employees are common to employers worldwide. Whether an employee is working in Jakarta, London or New York at termination of the employment relationship makes little difference. From any location he or she could take or fail to return your business's trade secrets or other confidential information, or solicit its customers using the goodwill belonging to your business, or otherwise compete with your business taking unfair advantage of his or her knowledge of your business.

While the nature of the threats presented may not differ materially from one country to another, the permissible methods for protecting a business from them will differ from location to location around the globe. Most jurisdictions will permit employers to require employees to agree to some restrictions on their post-employment activities and use of confidential information. However, there is wide variance over the requirements imposed by specific jurisdictions to obtain protection and over the extent of protection that will be permitted.

## Restrictive Covenants in the U.S.

With notable exceptions, it is fair to characterize the U.S. as largely hospitable to most kinds of post-employment restrictive covenants: (i) nondisclosure-confidential information agreements; (ii) agreements not to solicit (a) employees or (b) customers; and, to a lesser extent, (iii) covenants not to compete. Like most generalizations, however, this one is subject to important exceptions and is dependent on the satisfaction of certain requirements.

### The States Make the Rules

In the American federal system of government, in some areas that affect commerce between the states the national government — specifically, the Congress — has chosen to step in and pass laws that regulate that area in a uniform way. Thus, federal laws exist that set minimum national standards on matters such as the environment, worker safety, minimum wage and maximum hours of work, to name a very few. In many cases states can and do share regulatory authority with the federal government and may set stricter standards for businesses and others within their borders. Some matters, however, are traditionally reserved for states to regulate. Employment agreements, including post-employment restrictive covenants, fall into this category.

This means that careful attention must be paid to the law of each state in which your business employs workers. This is a simple fact of doing business in the U.S. With a few glaring exceptions, California being the most significant, and with nuances that may be unique to some states, most states are at least consistent with one another in fixing rules that govern most post-employment restrictive covenant issues.

### The Courts Make the Rules

In most states, the rules to follow to make a restrictive covenant enforceable have been created by the courts and not by statute, and have evolved over many years as part of the common law of the state. This has created some ambiguity in the laws of most states, which is best characterized as an absence of detailed rules that permit a company and its counsel to predict with certainty that a specific covenant will be found enforceable. What have instead emerged are broad principles that courts apply to the facts presented on a case-by-case basis. Thus, while it often is impossible to state with complete certainty that a restrictive covenant will be enforced as written, reasonable predictions generally can be made.

## U.S. Restrictive Covenants: The Guiding Principles

The courts in most states have declared at one time or another that the law favors free and open competition and that for that reason, restrictive covenants — and especially covenants not to compete — are disfavored by the law. In

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one state — California — the legislature long ago enacted a statute that the courts have interpreted as *barring* the enforcement of covenants not to compete and dramatically restricting the scope of lawful non-solicitation agreements. The following discussion does not apply to restrictive covenants in California (which will be the subject of a later article).

Because they are "disfavored" as limitations on free commerce, the courts in nearly every state require an employer to bear the burden of proving that the restrictive covenant it seeks to enforce is *reasonably necessary for the protection of a protectable interest*. While there are many differences in how this standard is applied from state to state, and even from court to court within a state, there are some guiding principles.

### Protectable Interest

An employer may not simply decide that it doesn't want a particularly skilled or valuable employee to work for the competition, or that an employee should not solicit any of its customers on behalf of a subsequent employer. Instead, it must show that one or more of its legitimate, recognized interests would be materially damaged, or that it would be give the competitor an unfair advantage, were the employee to work for a competitor. Most often the protectable interest asserted is either the loss or misuse of trade secrets or other confidential information which gives the new employer an unfair competitive advantage, or the misappropriation of goodwill belonging to the former employer, also unfairly advantaging the new employer. Courts in some states have recognized other interests — such as the employer's recent investment of substantial training resources in the departing employee — as sufficient to justify enforcement of a non-compete in specific cases if supported by evidence that the employer incurred unusual expense and would suffer injury were the employee to take that recently acquired skill or knowledge to a competitor. A departing employee's knowledge of the skill sets and compensation levels of the employer's workforce can support enforcement of a restriction on soliciting its employees.

### The Scope or Extent of the Restriction

In addition to demonstrating a protectable interest, courts require an enforceable restrictive covenant to be limited to the scope necessary to protect that interest. This means that the covenant must be limited to only the geographic area and length of time necessary to protect the employer's interests, and it must not be any broader substantively than needed. In this latter regard, it must be tailored to fit the employer's business and the employee's skills and responsibilities and not restrain the employee from working for a company or engaging in activity that would not unfairly threaten the employer's actual and legitimate business interests. In making determinations on these issues the courts have much room to exercise their discretion.

In many states, the courts exercise the authority to scale back, also referred to as "blue pencil," restrictions that are found to be too restrictive in view of the employer's legitimate interests and the threat actually posed by the former employee. This discretion generally will be exercised only if the court finds that the employer did not knowingly impose an unenforceable restriction hoping to deter the employee from engaging in lawful activity. Some states, e.g., Georgia, refuse to revise the parties' agreement and will simply refuse to enforce an overly broad restrictive covenant.

## Conclusion

An enforceable restrictive covenant may be of great importance to the security of your trade secrets and customer relationships, and to other competitive interests that your U.S. business has or will have. However, while it is generally possible to create enforceable covenants in the U.S., it can be a tricky endeavor and one that requires partnership with experienced counsel.



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