Publications

The Truth About Restrictive Covenants: Great Protection; Bad Reputation

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A key employee just resigned, took a thumb-drive containing gigabytes of your company's confidential information, and is now working for your competitor. Your customers are being solicited and key employees are receiving job offers enticing them to leave. What would you do? What could you have done?

Scenarios like this are occurring with greater frequency now that the job market is improving, talent is highly sought after, and electronic information is easy to take. Gone are the days when paper files locked in a file cabinet offered sufficient protection. Electronic information can be taken in massive quantities without a business even knowing the scope or quantity of what has been taken.

In these situations, many businesses find that they lack adequate tools and procedures to effectuate meaningful damage control. Often this is because the company did not understand and utilize the protections offered by restrictive covenants because of the common misconception that "non-compete agreements" are unenforceable. But this view reflects a lack of understanding of the different types of "restrictive covenants" and how, when properly used, they can be invaluable tools to protect a business.

Understand the different types of "restrictive covenants"

Think of the term "restrictive covenants" as the "entrées" heading on a menu. The law serves different types of restrictive covenants, all of which provide distinct protections and which can be drafted to properly fit and protect your business.

- "Covenants not to compete" or "non-competes" as they are commonly known, limit a former employee's ability to work for a period of time in an industry, or for one or more competitors. These covenants can be customized as to duration, scope and geographic territory.
- "Non-solicitation" covenants restrict a former employee's ability to solicit business from customers or clients. They, too, can be customized, such as by defining "solicitation" in a highly specific manner (e.g., sending e-mail blasts, calling key contacts, and promoting a new employer on LinkedIn) or by restricting the former employee from "servicing" or "accepting" business from customers or clients.
- "Non-poaching" covenants impose economic disincentives on former employees who cause or try to induce existing employees to resign and work elsewhere, such as for your competitors, or for a new business venture started by the former employee.
- "Confidentiality provisions" when drafted properly, clearly define the type of critical information (e.g. customer lists, sales data, current files, business plans) that a former employee may not take, possess or use after the employment relationship ends.

Your business can utilize some or all of these covenants, but they should be drafted properly in order to maximize both their effectiveness and the likelihood that a court will enforce them if litigation becomes necessary. To better explain why restrictive covenants belong in every responsible employer's business planning, certain common myths and misconceptions should be understood and considered.

Common misconceptions about restrictive covenants

New York disfavors restrictive covenants and courts won't enforce them.

Many individuals, including attorneys, believe that restrictive covenants are not enforceable in New York. This is not the case. Courts will enforce restrictive covenants that reasonably protect a company's legitimate business interests. Examples of such interests are the goodwill associated with customer or client relationships, confidential information, or protection against competition from an employee found to be "unique," "extraordinary" or who maintains close relationships with key client/customer contacts. Courts in New York will not enforce a restrictive covenant that is not designed to protect an actual legitimate protectable interest or whose purpose is merely anti-competitive.

All of our employees sign employment agreements so we don't need anything else.

A written employment agreement alone offers limited post-employment protections. Without restrictive covenants, New York law provides – with limited exception – no prohibition against an employee leaving to work for a competitor, soliciting away business, and inviting other employees to do so as well. Properly drafted

restrictive covenants (which can be contained within an employment agreement) offer the best protections against post-employment business disruption. In addition, the inclusion of such covenants in a written agreement often has a prophylactic effect and can "give pause" to an employee who is planning to depart or a prospective employer who is reviewing the contract while considering whether or not to hire your employee.

All of my employees signed agreements with identical restrictive covenants that we obtained from a lawyer years ago, so we are protected.

"Form" or "boilerplate" language that neither identifies nor focuses on the legitimate interest to be protected is much less likely to find favor from a judge. This is especially so where the Court is being asked to prevent a former employee from working and earning a living. Also, laws change, as does the manner in which courts view restrictive covenants. Not all attorneys are familiar with nuances that are often the differentiators between those covenants that are enforceable and others that are not. The "one size fits all" approach may look good on paper but, in reality, offers a false sense of security. Moreover, a competitor and its savvy counsel who review formulaic restrictive covenants may feel empowered with the knowledge that these covenants are less likely to withstand judicial scrutiny. Consider also that if "standard" language is used in all of your agreements, and it is found to be unenforceable, the protections that were thought to be in place might disappear for an entire group of employees.

We learned that an employee was planning to leave and start her own business so we beat her to the punch by terminating her.

Your strategy backfired. Nothing prohibits an employee from planning to leave. Merely planning to leave, without doing more, is not unlawful and is not "cause" for termination. Under existing New York law, other than regarding the use of confidential information, restrictive covenants will not be enforced against an employee discharged without cause. By terminating the employee under these circumstances you likely voided otherwise enforceable covenants. Strategic planning with experienced employment counsel could have placed you in a far better position.

We are protected because our employee handbook contains restrictive covenants.

Even if an employee receives or "signs for" an employee handbook containing restrictive covenants this likely offers no protection. This is because employee handbooks almost universally contain disclaimers that they are not intended as a contract of employment. Further, since the employee has no ability to "negotiate" the terms contained in the handbook, and the employer retains the right to modify the policies in the handbook, a court will not treat any restrictive covenants as a binding or enforceable "arm's length" negotiated agreement.

It is advisable to "wait and see" what happens before taking action.

Damage can occur quickly, especially when a business does not know the extent of the former employee's prior actions and future plans. A "wait and see" approach is akin to hoping a small fire will extinguish itself rather than spreading. The risk is rarely worth it, especially when a properly drafted agreement can promptly provide tremendous protection and leverage in negotiations. Also, time is the enemy when asking a court for an order granting immediate relief (such as a prohibition on soliciting or accepting business from certain customers or clients). Immediate injunctive relief will only be granted where a showing of "irreparable harm" can be established. Waiting even a few weeks seriously undermines such an argument, because if the harm had been viewed as truly irreparable, a responsible business would be unlikely to wait so long to seek relief in court. Prompt action may also cause the former employee and the new employer to rethink their strategy and instead to seek amicable resolution rather than face the prospect of continued litigation. Well-drafted covenants bolster a company's bargaining position in such negotiations.

Protect your assets

Properly drafted restrictive covenants are inexpensive tools that offer security before they are needed and tremendous protection if enforcement becomes necessary.

Things to remember:

- Draft restrictive covenants for mergers and acquisitions, hiring executives and key employees; and updating existing partnership, operating or employment agreements
- Evaluate the restrictive covenants of your potential hires to assess risks and devise and implement strategies to accomplish your business objectives
- Develop protocols to follow if an employee defection is suspected
- Prepare action plans for when an employee leaves
- Negotiate business solutions with former employees and their new employer to avoid litigation
- Commence litigation involving restrictive covenants to protect your interests.

About the Authors

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