



An Initial Guide to Post-Employment Restrictive Covenants

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On Monday morning, at 9:00 AM, you receive the following email from your Chief Executive Officer: “Our Senior Vice President of Sales just tendered his resignation without notice. To make matters worse, I received a notification from LinkedIn a few minutes ago that he is assuming the same position for a direct competitor. What do we do now?” Rather than an SVP of Sales, perhaps it’s the Chief Technology Officer, the Head of Product Development, or an employee with a unique skillset that the company cultivated at a significant expense. In each case, however, the employee’s defection to a direct competitor represents a significant risk to the company’s competitive advantage that you have a limited ability to address absent the presence of an agreement between the parties restraining the employee from competition. Enter the restrictive covenant – a widely used contractual clause in the U.S. which restricts a terminating employee from engaging in various competitive activities for a defined, post-employment period. This article will briefly address an employer’s need for restrictive covenants, followed by a discussion of the various types of covenants that companies employ to protect their business interests, including how (and to what extent) those covenants may be enforced.

What Is The Purpose of a Post-Employment Restrictive Covenant?

Employees, and in particular, high-level management and executive employees of the type presented in the scenario above, are likely to obtain confidential information and know-how during the course of their employment, including key business strategies, client

names and preferences, supplier information, techniques, designs and unique skills. Additionally, employees will also develop relationships with key customers by virtue of the company’s goodwill. Pursuant to U.S. common law, current employees have a duty to refrain from acting in a manner that is adverse to their employers’ best interests, including engaging in competitive activities. However, former employees generally do not have a similar duty and are free to engage in direct competition with their former employers. Accordingly, upon termination of the employment relationship, employees may be tempted to solicit customers or employees, and/ or use information of the type identified above, to either further the interests of a competitive employer or for their own account. Although some of this information may be protected from disclosure under various state or Federal laws (e.g. the recently enacted Defend Trade Secrets Act), these laws do not prohibit former employees from actually going to work for a competitor or from soliciting customers and employees. In an effort to protect against these potential threats, many companies in the U.S. require employees, as a condition of employment, to enter into confidentiality agreements or employment agreements which contain restrictive covenant clauses.

Common Restrictive Covenant Clauses

The most common types of post-employment restrictive covenants include non-competition clauses and restrictions prohibiting the solicitation of customers/ clients and employees, each of which are in effect both during the employment relationship and for defined period thereafter (e.g. six months). Some employers also require individuals to refrain from interfering with key business relationships, such as relationships with suppliers.

1. Non-Competition. A non-competition clause is intended to prevent an employee from working for, advising, consulting or otherwise engaging in any business with a competing company. While there are

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numerous ways to draft a non-competition clause, the provision should specifically define what a competing business is, should designate a specific geographic area in which the employee is restricted from competing (if applicable), and should limit the scope of the employee's competition to engaging in a similar capacity for the competitor as the individual was engaged in by the employer (e.g. a marketing executive should not be prohibited from working for a competitor as a security guard).

2. Customer Non-Solicitation. A customer non-solicitation clause seeks to prevent an employee from soliciting, advising, or attempting to do business with customers of the company. The provision should define who is a customer and may even include a list of primary customers that, to avoid any doubt, the employee is explicitly prohibited from soliciting.

3. Employee Non-Solicitation. An employee non-solicitation clause is intended to prevent an employee from attempting to hire or retain employees of the company. The provision should define the relevant scope of employees (e.g. current employees and those employees who have been terminated in the preceding three-month period) and, where applicable, should be limited to the group or department of employees that the restricted individual actually interacted with.

Importantly, irrespective of the type of restrictive covenant at issue, the covenant must be designed to protect an employer's legitimate business interests, as employers are not permitted to prevent competition per se – that is, a restrictive covenant cannot be designed for the purpose of simply eliminating competition even if only for a short period of time. Examples of legitimate business interests include the protection of: (i) goodwill; (ii) long-term customer relationships; (iii) confidential information (including trade secrets); and (iv) an employee's special or unique skills. In addition, covenants must also be reasonably limited in scope, both in the length of the restrictive period and in the geographic area covered. Finally, the restrictive covenants must be supported by valid consideration which, in most U.S. jurisdictions, could simply be an offer of employment.²

Enforcement of Restrictive Covenant Clauses

Prior to seeking any relief from a court, employers will often seek to deter a potential breach by sending a communication to the terminating employee and his/her new employer reminding the parties of the individual's obligations under the relevant restrictive covenant clauses. Such communications may successfully achieve the desired result without the legal expense necessary to enforce the applicable covenants and the uncertainty in proceeding to litigation.

However, in the event a terminating employee does breach a restrictive covenant clause, the former employer can seek to restrain the employee's breach by requesting immediate injunctive relief from a court. In addition to asking a court to enforce the terms of the parties' agreement, employers will also request that a court restrain the employee from engaging in the alleged breach while the parties dispute whether or not a breach in fact occurred.

It is important for employers to note, however, that restrictive covenants are generally disfavored under the law and their enforcement will depend on myriad factual issues and the predilections of the particular judge assigned to the case. As a result, the deterrent effect of a restrictive covenant is often equal to the potential value of its enforcement.

Conclusion

Restrictive covenants are an invaluable tool for companies to both deter and prevent unfair competition threats to their businesses, and to protect their confidential information. Companies of all types and sizes should take time to evaluate which employees hold their key confidential information and business relationships, or otherwise possess unique or extraordinary skills, and present those employees with agreements containing restrictive covenant clauses in order to better protect the business. While employers may encounter difficulty enforcing these agreements, that is ultimately a good problem to have where the alternative is having no agreement in place at all.

² A complete discussion of what may constitute adequate "consideration" for a restrictive covenant is beyond the scope of this article. However, employers do have a number of potential options at their disposal including offering new or current employees a sign-on bonus in exchange for their execution of the agreement. Additionally, courts in a number of U.S. jurisdictions have also found that the continuation of an "at-will" employment relationship may be sufficient to constitute adequate consideration for a current employee's signing of a restrictive covenant.