Your Color-Coded Crib-Sheet to Creating Compelling Restrictive Covenants

By Laurent S. Drogin

There is an oversimplified view in the press and on social media – and some members of Congress – that "non-competes" are bad— very bad—and that employers are far too aggressive in enforcing them. These opinions understandably flow from reports of non-competition clauses abusively enforced against low-wage employees such as sandwich makers and dog sitters. To fix this "problem," a group of Democratic Senators introduced the Workforce Mobility Act of 2018 (WMA) (Senate Bill 2782, with an identical version in the House at H.R. 5631). While one web resource gives the House Bill a 2% chance of becoming law, the proposal itself is emblematic of how some lawmakers overreact to solve a limited problem by aggressively targeting businesses without fully understanding the landscape. Corporate counsel should treat this development as an opportunity to consider and assess how their clients use restrictive covenants.

The proposed WMA would impose a flat ban on all "covenants not to compete" for all U.S. employers and employees engaged in "commerce." There are likely very few businesses with corporate counsel who can claim not to operate "in commerce." By its terms, the WMA's ban would provide that "[n]o employer shall enter into, enforce, or threaten to enforce a covenant not to compete with any employee of such employer, who in any workweek is engaged in commerce or in the production of goods for commerce (or is employed in an enterprise engaged in commerce or in the production of goods for commerce)." The bill defines a "covenant not to compete" broadly to mean:

> an agreement, entered into after the date of enactment of this Act between an employer and an employee, that restricts such employee from performing, after the employment relationship between the employer and the employee terminates, any of the following: (A) Any work for another employer for a specified period of time. (B) Any work in a specified geographical area. (C) Any work for another employer that is similar to such employee's work for the employer that is a party to such agreement.

It also provides for civil fines and a private right of action (including punitive damages) against violating employers, and carves out confidentiality provisions consistent with the Defend Trade Secrets Act, 18 U.S.C. §1836.

The proposed legislation takes the phrase "covenant not to compete" and defines it in a way that ignores the distinction between a true "non-compete" and other types of "restrictive covenants" that can and should remain available to employers. By so doing, the proposed legislation perpetuates and adds to the confusion rather than educating and attempting to solve a legitimate problem – misuse of non-competes on employees who pose no threat to their employers should they changes jobs.

The term "non-compete" is often used generically to include any type of post-employment restriction which operates to limit what a former employee can do elsewhere. Actually, a "non-compete" is a species within the restrictive covenant genus. Restrictive covenants, one type of which is a non-compete, also include contractual provisions that limit employees from soliciting, accepting and servicing business from a former employer's clients or customers; no-hire provisions that limit former employees from hiring or inducing other employees to

leave; and confidentiality provisions that intend to limit a former employee's use of confidential information and trade secrets. The WMA fails to appreciate this.

Although the WMA seems unlikely to become law, attorneys have been given an insight into how the legislature views the problem. From this understanding, "better" more enforceable covenants can be drafted and, therefore, stand a better chance of being enforced. Understanding the dynamic will also better enable corporate counsel to recognize flawed and susceptible covenants possessed by potential hires, in evaluating litigation risk from the former employer.

The central issue to restrictive covenant enforceability is whether or not the provision is "anti-competitive" or serves to protect a "legitimate business interest." Often, the legitimate protectable interest is goodwill; the anticipated continued patronage from an existing customer or client, and continued employment of existing employees. A party seeking enforcement of a covenant deemed "anti-competitive" is doomed to fail. The key is to fashion your covenant to fit the actual risk of harm. Some legislation focuses on wage level. For example, Massachusetts' new law makes non-competes unenforceable against wage earners who are classified as non-exempt under the Fair Labor Standards Act. This can miss the mark, for example, where a non-exempt employee has access to confidential information – a legitimate business interest courts will routinely protect.

The tables below use color coding as a general guide. Green indicates the greatest likelihood for need and judicial enforcement, whereas red suggests just the opposite.

Risk vs. Type of Covenant

Risk	Non-Compete	Non-Solicit/ Accept/Service	No-Hire	Confidential information and trade secrets	Common law restriction on use of confidential information and trade secrets
Low					
Medium					
High					
C-Suite					

A brief word about confidential information and trade secrets, all of which are depicted as "green" above: Even without a written covenant, the common law protects former employees from using confidential information and trade secrets. This is not to say that such a covenant should not be included. It is a belt and suspenders "best practice." Critical, however, are the definitions of what information is really confidential, and what are protectable "trade secrets." A detailed discussion of these points is beyond this article. However, do consider that some information is forever confidential (take for example the KFC recipe?) whereas other information such

as pricing information or forms of technology gets stale over time. Take care when drafting time limitations on such provisions. Consider whether the turn of a calendar page really determines whether something is confidential.

Non-Competition Considerations

With a true non-compete, the former employee is on the sidelines. Apply the adage "less is more." The first question to ask is: "Do I really a need a non-compete at all?" If it really does not matter where the employee works, then omit a non-compete altogether. You will have a lot more credibility being able to say: "We don't mind if they work there, but here are the concerns we have …." If a true non-compete is warranted, be guided accordingly.

Scope	Entire industry	Business unit / type	Specific Competitors	Single Competitor
Geography	World	Anywhere we do business	Anywhere the employee worked	Specific location / radius
Duration	Over 24 months	12-24 months	6-12 months	Less than 6 months

Scope: Where does the employee really pose the greatest threat?

Geography: Since so much business is done electronically, do you need this at all? Note that radius clauses are often limited and used by businesses that rely on local commerce. Think doctors and hair salons. On the other hand, a Director of Marketing can be equally potent next door or around the world.

Duration: This is pretty straightforward. The less time you ask for (and the greater the compensation paid during this period), consider defining "tranches:" A, B and C (6 months); X, Y and Z (12 months).

Non-Solicit/Accept/Service

Type	Non-solicit	Non-accept	Non-service	Specific clients/customers
Relationship	Anyone we do business with / friends and family	Anyone who you brought to us	Any business you worked on	What you originated and worked on
Duration	Pick a number	Industry average	Exclusive relationship	Expiration of engagement / mobility
Revenue loss	Zero	Minor	Speculative or hard to calculate	Major

Scope: As a general rule, a court is more likely to protect a legitimate business interest by prohibiting someone from soliciting, directly or indirectly, and even more so when the restriction is limited to a small select group of clients or customers. Non-accepts, labeled yellow above, are intended to stop the "they called me, I didn't solicit them" situation. Courts will generally accept that. However, where the business finds its way to the competitor and the former employee through legitimate channels, a court may view the restriction as being overreaching. To this point, if the covenant is limited to a subset of clients or customers, a court may be impressed that you are taking care to limit the restriction to what you perceive as an actual need.

Relationship: Not every business relationship warrants protection. Thus, the proximity of the business to the employee is also a very important consideration. Clauses that address "all of our customers" as opposed to just those that the employee worked on will be more deeply frowned upon.

Duration: There ought to be a logical explanation for why the duration is reasonable. A blanket prohibition of more than two years is going to invite skepticism. The ability to say: "Our average and similarly situated client/customer is with us for six years, and we are seeking a three year restriction" is more compelling than simply asking for three years. Caution should also be taken because not all courts will "blue pencil." A court is free to "red pencil" a covenant, meaning if it is deemed unenforceable, it will be stricken rather than rewritten by the court. Favor will be found if you can demonstrate that you have an exclusive business relationship for a particular period of time. The fact that your client has committed to you will impress on a court that protection is necessary.

Finally, some relationships, like insurance policies, have expiration dates and set terms. Each renewal is a test of goodwill. Will the client/customer shop around or are they loyal? A court is likely to endorse a time restriction that makes sense because it gives you a reasonable and fair chance to maintain the business without interference. Thus, if an insurance policy expires in nine months, a covenant that runs: "the lesser of 18 months from the end of employment or six months from each policy renewal date" may be a better fit than a blanket 24 month restriction.

Revenue loss: If the loss of the business relationship is worth protecting, you need to convince a court that bad things will happen without its intervention.

No-Hire (a/k/a no poaching; no raiding)

First of all, covenants that restrict the ability of an employee to lure others away are enforceable. But as with other covenants, they must meet a reasonableness test.

Who?	C-suite	Key people	Sales / mid-level	Lower level
Where?	Anywhere	Industry	Competitor	Where you are
How many?	Department/division /specialized group	A lot	A few	One key person
Duration	Years	Months	While employed	Former employees

Damages	Lost profits	Liquidated damages	Formula	Replacement cost

Who? This is pretty logical. The higher you go up the ladder, the more a court will understand the need for protection, especially when the employee(s) are likely to have knowledge of confidential information and trade secrets.

Where? A well-drafted no-hire provision will limit its application to where the target is likely to move. Encouraging a CEO of a pharmaceutical company to cash out and open a shoe store 1,000 miles away is very different than suggesting they join you at a competitor across town.

How many? Here, courts look to the damage likely to be caused by departure. A handful of production line supervisors differ from a key employee at any level or an entire business group. What is the real fear?

Duration: Courts are likely to view as "purely anti-competitive" covenants that extend out for years or to former employees, especially those whose employment was ended by the employer without cause. Existing employees warrant the most protection. We often see covenants linked solely to the end of the contracted-employee's separation date: "shall not, for a period of 12 months from their last date of employment …." That means one day later everyone is fair game. A longer covenant may be enforced if it precisely targeted: "shall not, with regard to any then-existing employee with whom Employee worked in the widget-department…." This reflects a concern about an outbound employee targeting key employees 12 months and 1 day later, as opposed to having the restriction apply longer to people with whom the employee worked.

Damages: Care must be taken here if this type of covenant is really to be enforced. Recognize that an employee who is solicited to leave, but who does not have a restriction of their own, is unlikely going to be compelled not to work by a court. Thus, the economic harm needs to be sought from the contract-breaker. Lost profits guarantee only one thing: protracted litigation and experts who disagree. Liquidated damages must be used wisely. Where necessary, the liquidated amount can be tied to the level of hierarchy of the poached employee. Even better, derive a formula tied to a rational metric, such as compensation, rank and duration of employment. Losing a security guard of six months is different from losing an HR director with 10 years of institutional knowledge. Courts do like covenants that tie damages to "replacement cost," which is why the box is shaded green. But this is akin to "lost profits" in many ways, as it is hard to prove, so an orange tint is just as correct.

Conclusion

It is something of a mantra for lawyers who draft them that there is no such thing as a one-size-fits-all covenant that can be copied and pasted into any employment contract. Employers who intend to enforce a restrictive covenant are well-advised to take the time to craft them to increase their enforceability. Better drafting and application of covenants may quell legislative meddling. Likewise, a better understanding of poorly drafted covenants will better enable corporate counsel to assess the risk of hiring employees with existing covenants, and advise on the likelihood that enforcement of the new-hired employee's covenants can be defeated if litigation is commenced by the former employer.

About the author:

Laurent S. Drogin: A founding partner of Tarter Krinsky & Drogin LLP, Laurent heads the firm's Labor and Employment Practice, and co-heads its Restrictive Covenant subgroup. Working with his clients to understand their short-term legal needs and long-term business goals, Laurent develops solutions that help achieve both. He is passionate about serving his clients' business interests first and using the law to achieve their goals. Recognizing that awareness, prevention and compliance are keys to avoiding litigation, Laurent guides clients in litigation avoidance techniques and handles litigation and dispute resolution on a wide range of matters such as restrictive covenants, employment agreements and severance issues. He also counsels and litigates matters involving compliance with federal, state and local employment laws, including harassment, discrimination, medical leave and investigations, audits and class/collective actions under federal and state wage and hour laws. Learn more about him: http://www.tarterkrinsky.com/bios/laurent-s-drogin