
Restrictive Covenants: Recent Developments, Best Practices and Strategies for Preserving Human Capital

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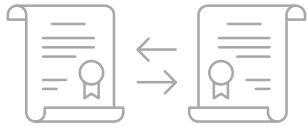


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Topics Overview



1 Recent Developments



2 Comparison of New York, Massachusetts, and California Laws on Restrictive Covenants



3 Best Practices for Drafting Restrictive Covenants



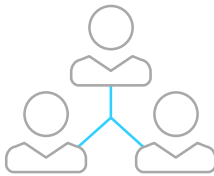
4 Litigating Restrictive Covenants

Overview of Restrictive Covenants



Non-Competition

Restrictions against providing services for or investing in a competitor



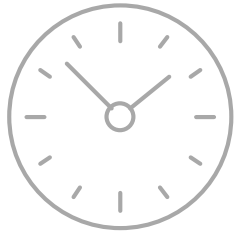
Non-Solicitation

Restrictions against soliciting or interfering with relationships with customers or employees



Non-Disclosure

Restrictions against the disclosure of confidential information and trade secrets

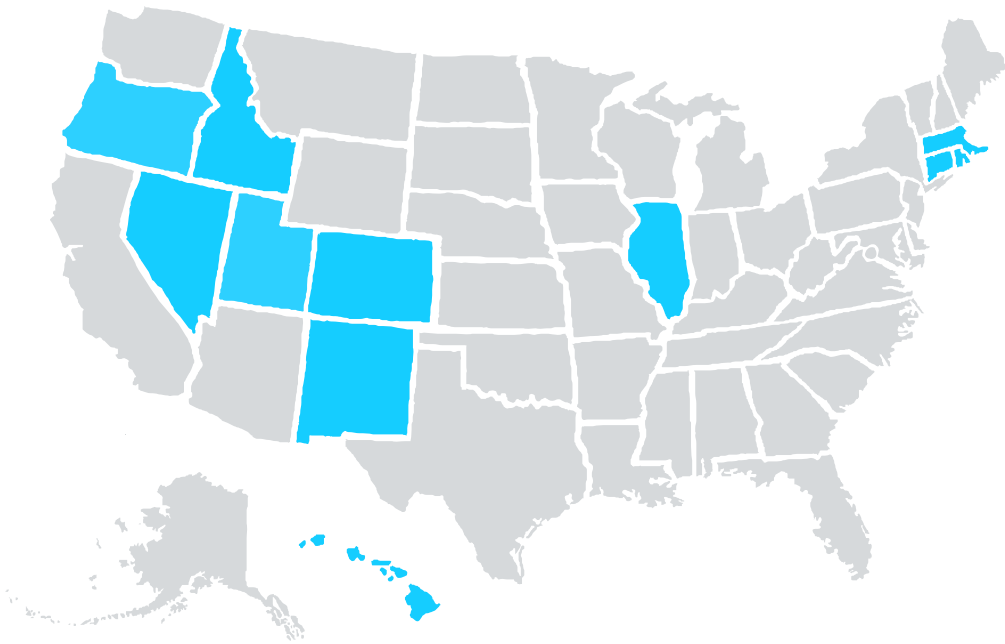


PART ONE:
Recent Developments

Recent Developments

STATES RESTRICTING THE USE AND SCOPE OF NON-COMPETES

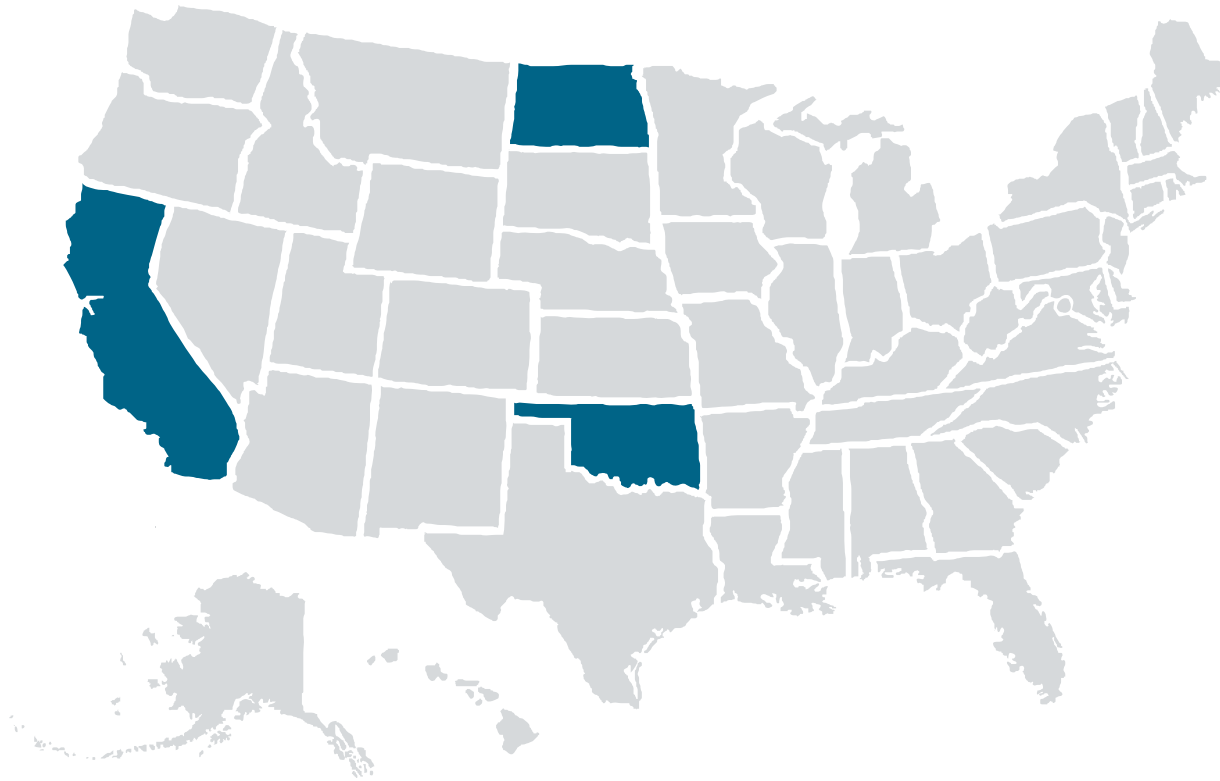
In recent years, many state legislatures have limited the use and breadth of non-competes in employment agreements in response to a 2016 White House Call to Action



- **Massachusetts** enacted a law, effective in October 2018, limiting the use of non-competes and setting certain “reasonableness” standards
- **Utah, Oregon, and Nevada** recently enacted employee-friendly amendments to their non-compete laws
- **Idaho** repealed a 2016 provision in its non-compete code that made it easier for companies to restrict the movement of “key” employees
- **Illinois** passed legislation that prohibits non-compete agreements for “low-wage employees”
- **Rhode Island, Colorado, Connecticut, and New Mexico** have prohibited or limited non-competition agreements in the medical field, and
- **Hawaii** has banned them for technology businesses

Recent Developments

STATE-LEVEL BANS ON NON-COMPETES



Currently,
California,
North Dakota,
and
Oklahoma
have general
bans on
employment-
based non-
competes

Recent Developments

PROPOSED LEGISLATION BANNING NON-COMPETES NATIONWIDE



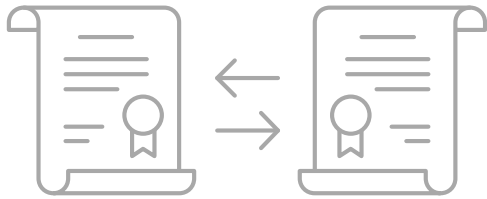
Workforce Mobility Act

In April 2018, Democratic U.S. Senators Elizabeth Warren, Chris Murphy, and Ron Wyden introduced legislation entitled the **Workforce Mobility Act (“WMA”)** that would **prohibit the use of non-competes nationwide**



- Similar legislation has been introduced in the House of Representatives

This legislation would authorize the U.S. Department of Labor to enforce the ban and would provide a private right of action to seek compensatory and punitive damages as well as attorneys’ fees



PART TWO:
Comparison of New York,
Massachusetts, and California
Laws on Restrictive Covenants

Comparison of Laws on Restrictive Covenants

NEW YORK



Non-Compete Agreements

- No statute governing non-competes in New York
- **Non-competes are disfavored but may be enforceable** if they are:
 - Necessary to protect an employer’s legitimate interests (e.g., to protect trade secrets or goodwill or where employee has “unique” special skills)
 - Not harmful to the general public
 - Not unreasonably burdensome to the employee
 - Reasonable in duration and geographic scope
- Enforcement issues arise if employee is terminated without cause
 - *Buchanan Capital Markets, LLC v. DeLucca*, 144 A.D.3d 508 (N.Y. App. Div. 2016)
 - *Hyde v. KLS Prof'l Advisors Grp., LLC*, 500 F. App'x 24 (2d Cir. 2012)

Comparison of Laws on Restrictive Covenants

NEW YORK



Non-Solicitation Agreements

- **Generally enforceable:** Analyzed under same standard of “reasonableness” that applies to non-competes, but non-solicitation agreements are generally viewed as more reasonable and less burdensome than non-competes

Non-Disclosure Agreements

- **Generally enforceable:** Restrictions need not be limited in time or geographic scope and may last forever

Comparison of Laws on Restrictive Covenants

MASSACHUSETTS



Non-Compete Agreements

- A new law, effective in October 2018, introduces the following bright-line “reasonableness” standards for non-competes:
 - **Duration:** Cannot exceed 12 months (unless the employee breaches fiduciary duty or steals employer’s property, then the duration can be up to 2 years)
 - **Geography:** Presumptively reasonable if limited to the areas in which the employee “provided services or had a material presence or influence” during last 2 years of employment
 - **Scope of prohibited activity:** Presumptively reasonable if limited to the specific types of services provided during the last 2 years of employment

Comparison of Laws on Restrictive Covenants

MASSACHUSETTS



Non-Compete Agreements

- **Non-competes not enforceable against certain types of employees:** Includes employees terminated “without cause” or laid off and non-exempt employees under the Fair Labor Standards Act
- **Carve-out** for non-competes contained in separation agreements that provide at least 7-day right of rescission
- **Garden leave:** Non-compete must include a “garden leave” clause, which would require employer to pay at least 50% of employee’s annualized base salary within the last two years, or “other mutually-agreed upon consideration”
- **Additional consideration:** If the non-compete is entered into during employment, additional consideration is required
- **Choice of law:** Cannot avoid the law’s requirements by applying the law of a different state

Comparison of Laws on Restrictive Covenants

CALIFORNIA



Non-Compete Agreements

- **Void by statute** except in very limited situations (California Business & Professions Code §16600)
- **Limited statutory exceptions** to the general ban include covenants made in connection with a:
 - Sale of business, which must include sale of goodwill
 - Sale of all of an owner's interest
 - Dissolution of or disassociation from a partnership or LLC
- **Forum selection and choice-of-law clauses** that designate the law of a state favorable to non-competes are disregarded
- **Forfeiture of benefits:** Agreements that require forfeiture of employee benefits when an employee competes are voided

Comparison of Laws on Restrictive Covenants

CALIFORNIA



Non-Solicitation Agreements

- **Limited enforceability:** Customer non-solicitation agreements may be enforceable if reasonable and necessary to protect an employer's trade secrets
- Employee non-solicitation agreements may be enforceable unless they are blanket "no hire" covenants prohibiting any hiring of a company's employees

Non-Disclosure Agreements

- **Generally enforceable** as the state is protective of confidential information and trade secrets



PART THREE:
Best Practices for Drafting
Restrictive Covenants

Best Practices for Drafting Restrictive Covenants

INITIAL QUESTIONS FOR DRAFTING: 5-STEP APPROACH



1

What law
will apply
?



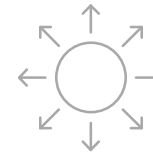
2

To whom
does the
covenant
apply
?



3

Where to
include
the
covenant
?



4

What is
the
scope of
the
restraint
?



5

What
are the
remedies
?

Best Practices for Drafting Restrictive Covenants

INITIAL QUESTIONS FOR DRAFTING: 5-STEP APPROACH

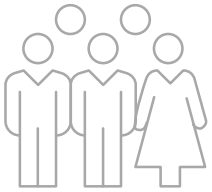


1. What law will apply?

- Location of company
 - Where is it headquartered?
 - Where is it organized?
 - Where are the employees?
- Contract law generally governs choice of law or venue unless contrary to public policy
 - But some states limit choice of law or venue by statute
- Global companies should consider international issues
- Choice of law matters for many reasons including:
 - The limits on the scope of the covenants
 - Any exceptions for sale of business
 - Seller covenants may be subject to less stringent requirements

Best Practices for Drafting Restrictive Covenants

INITIAL QUESTIONS FOR DRAFTING: 5-STEP APPROACH



2. To whom does the covenant apply?

- Employees
 - All employees or only executives and key employees
 - State law may limit to whom the covenant applies
- Lawyers
- Sellers of businesses
 - A seller of a business can enter into more expansive restrictive covenants (e.g., longer durational restraint)
 - Particularly important for sales of founder businesses, such as in the tech and biotech fields
 - Consider equity award holders
 - Exceptions for sellers from statutory regimes (e.g., Massachusetts and California)

Best Practices for Drafting Restrictive Covenants

INITIAL QUESTIONS FOR DRAFTING: 5-STEP APPROACH

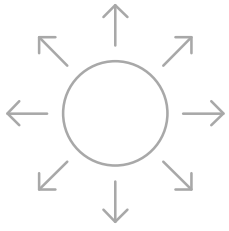


3. Where to include the covenant?

- Employment documents
 - Offer letter
 - Standalone restrictive covenant, such as a non-compete
 - Equity awards
 - Employment, change in control, or separation agreement
 - Proprietary information and inventions agreement (PIIA)
- Documents related to sale of business
 - Transaction agreement
 - Other documents, such as standalone restrictive covenant or employment agreement for post-sale period, should reference the transaction as a source of consideration

Best Practices for Drafting Restrictive Covenants

INITIAL QUESTIONS FOR DRAFTING: 5-STEP APPROACH



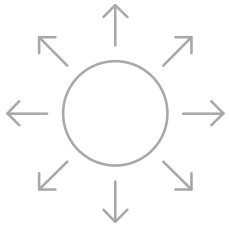
4. What is the scope of the restraint?

■ **Non-compete**

- Scope of restricted activity – possible variations:
 - “Any business that competes with the company”
 - List of proscribed competitors
 - Define competitive business (e.g., soft drinks)
 - Define competitive activity (e.g., employment, consulting, services, investing with carve-outs)
 - Business that company is considering at the time of termination or sale of business
- Geographic scope: Can be as small as a city (e.g., for a dentist) or as large as the world (e.g., for an internet service)
- Duration: Enforceable duration can be as short as a few months or as long as several years

Best Practices for Drafting Restrictive Covenants

INITIAL QUESTIONS FOR DRAFTING: 5-STEP APPROACH



4. What is the scope of the restraint? (cont.)

■ **Non-solicitation / non-disturbance**

- Scope of restricted activity: Solicitation of customers or employees; or disturbance of relationships with customers, employees, suppliers, or contractors
 - Restricted pool should be limited to actual or prospective employees or customers during fixed post-employment period (e.g., 6-month lookback); consider limiting to those with whom the employee has had contact
- Geographic scope: May be limited to areas of employment
- Duration: Can generally be longer than a non-compete

■ **Non-disclosure:** Can restrict use or disclosure of confidential information or trade secrets for potentially unlimited duration, with certain exceptions

■ **Non-disparagement**

Best Practices for Drafting Restrictive Covenants

INITIAL QUESTIONS FOR DRAFTING: 5-STEP APPROACH



5. What are the remedies?

■ Legal remedies

- Ongoing compensation arrangements (self-help)
 - Cancellation of outstanding options or termination of ongoing separation pay
- Prior compensation arrangements
 - Clawback of equity or separation pay

■ Equitable remedies: Should be detailed in covenant

- Injunctive relief

Best Practices for Drafting Restrictive Covenants

OTHER DRAFTING CONSIDERATIONS



Other Considerations and Issues

- More drafting pointers
 - Describe the consideration
 - Employee acknowledgements regarding substance and equitable remedies
- Potential traps
 - Integration
- Industry-specific issues (e.g., asset management track record)
- Accounting and Internal Revenue Code § 280G implications
- Carve-outs for whistleblower claims



PART FOUR:
Litigating Restrictive Covenants

Litigating Restrictive Covenants

PROTOCOLS FOR DEPARTING EMPLOYEES



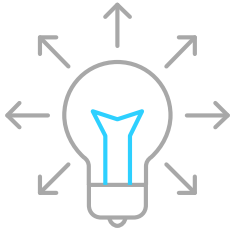
When an employee covered by restrictive covenants departs, consider **taking steps prior to departure** to prevent breach of those covenants

Possible Actions Prior to Departure

- Communicate in writing to the departing employee and, if appropriate, her new employer, to outline the employee's obligations under her restrictive covenants
- If you suspect the departing employee has violated or intends to violate her restrictive covenants, consider:
 - Utilizing software or technology consultants to investigate her data access and downloads
 - Reviewing emails or other communications for signs that the employee intends to join a competitor, to solicit your customers or employees, or for signs of other violative conduct

Litigating Restrictive Covenants

CONSIDER ALTERNATIVES TO LITIGATION



Before litigating, consider alternative routes to resolution, including settlement, which have the benefits of **speed, certainty, and cost savings**

Creative Settlement Strategies

- Obtain assurances regarding use of confidential information from employee and new employer
- Use technology consultants or programs to help track or purge confidential information from employee's devices and files
- Consider forfeiture and/or clawback of certain financial incentives for specific bad acts, such as disclosing confidential information
- Consider “garden leave” arrangement as an alternative or a companion to a traditional non-compete

Litigating Restrictive Covenants

HOW AND WHERE TO LITIGATE



Forum

- Consider favorability of the forum, if forum selection is possible
- Location of the employee and the company
- Choice of law and forum selection in the contract
- Public policy of applicable states
- *EBP Lifestyle Brands Holdings, Inc. v. Boulbain*, C.A. No. 2017-0269-JRS (Del. Ch. Aug. 4, 2017)



Remedies

- Equitable remedies
 - TRO or injunctive relief against former employee or new employer
- Damages
 - Compensatory damages
 - Punitive damages for malicious conduct
 - Liquidated damages

Litigating Restrictive Covenants

CASE STUDY: LITIGATING AN EMPLOYEE NON-COMPETE

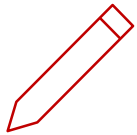


Singh v. Batta Envtl. Assocs., Inc., C.A. No. 19627 (Del. Ch. May 21, 2003)

- **Duration:** Two-year temporal restriction restraint was reasonable
 - Projects of the kind performed by the former employer required between one and a half to two years to complete
- **Geographic scope:** 200-mile restriction from the former employer's Georgetown office was not reasonable
 - 200-mile restriction would encompass much of Maryland, Washington, D.C., and Northern Virginia; restriction should be limited to Delaware
- **Legitimate business interests** in preventing departing employees from taking with them clients with whom they worked and using proprietary information obtained during former employment to compete
- **Not oppressive** to former employee because non-compete does not leave him without a means of financial support

Litigating Restrictive Covenants

JUDICIAL REVIEW: THREE APPROACHES



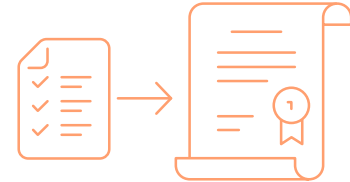
“Red Pencil”

Invalidate an overbroad non-compete in its entirety



“Blue Pencil”

Strike offending portions of a non-compete, but stop short of rewriting the agreement



Reform

Reform non-compete by inserting reasonable restrictions

Litigating Restrictive Covenants

JUDICIAL REVIEW: RECENT DEVELOPMENTS



***Brown & Brown, Inc. v. Johnson*, 25 N.Y.3d 364 (2015)**

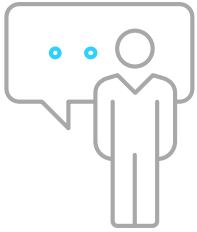
- The New York Appellate Division refused to partially enforce an overbroad non-solicitation agreement after finding that the employer imposed the covenant in bad faith, knowing that it was overbroad
- The Court of Appeals reversed and remanded on this issue because there were questions about whether the employer had used coercive bargaining power or had overreached, but it emphasized that New York courts would permit partial enforcement of restrictive covenants only where there was no employer coercion or overreaching

***Veramark Techs., Inc. v. Bouk*, 10 F. Supp. 3d 395 (W.D.N.Y. 2014)**

- The district court refused to partially enforce a non-compete barring the employee from competing “anywhere in the world,” because the covenant was “overreaching and coercive” on its face
- The court further noted that the non-compete’s language rendered partial enforcement inappropriate since partial enforcement would require a “wholesale revision” of the provision

Litigating Restrictive Covenants

SUING THE NEW EMPLOYER



Common claims arising out of hiring from a competitor include:

- Tortious interference with contract
- Aiding and abetting breach of fiduciary duty or duty of loyalty
- Misappropriation of trade secrets
- Unfair competition

Tortious Interference with Contract

■ Elements

1. Existence of a valid contract between plaintiff and a third party
 2. Alleged wrongdoers knowledge of that contract
 3. Intentional procurement of its breach without justification
 4. Damages
- Courts generally look for malice or “improper means”
 - *Great Am. Opportunities, Inc. v. Cherrydale Fundraising, LLC*, C.A. No. 3718-VCP (Del. Ch. Jan. 29, 2010)

Litigating Without Restrictive Covenants

MISAPPROPRIATION OF TRADE SECRETS OR CONFIDENTIAL INFORMATION



Statutory protection

- Trade secrets can be protected, even in the absence of a restrictive covenant
- Employees who misappropriate an employer's trade secrets may be liable under:
 - The Uniform Trade Secrets Act (UTSA), which has been passed in some form in 49 states
 - The Defend Trade Secrets Act of 2016
 - The Computer Fraud and Abuse Act (CFAA)

Common law protection

- Duty of loyalty and good faith

Litigating Without Restrictive Covenants

MISAPPROPRIATION OF TRADE SECRETS OR CONFIDENTIAL INFORMATION

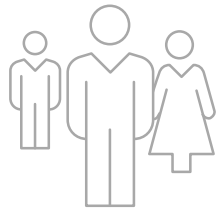


Inevitable Disclosure Doctrine

- Judicially-created doctrine that provides that a sufficiently senior executive, or well-placed employee, cannot purge herself of her former employer's confidential information and trade secrets and therefore will inevitably misappropriate such information if she directly competes with her former employer
 - Seminal case: *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262 (7th Cir. 1995)
- Courts vary in their willingness to invoke this doctrine, but a majority of jurisdictions that have adopted the UTSA have adopted some form of the inevitable disclosure doctrine
 - New York and Delaware recognize the doctrine in limited circumstances, while California and Massachusetts do not

Conclusion

TAKEAWAYS



1

One-size-does-not-fit-all



2

Be reasonable



3

Think outside the box

Questions

