Industry
ROUNDTABLE
RESTRICTIVE COVENANTS

PRESENTED BY: Hodgson Russ LLP ATTORNEYS

What industries typically use non-solicitation agreements? Are they enforceable? Why have restrictive covenants become more popular? Law firm Hodgson Russ and the *Albany Business Review* hosted a discussion to answer these questions and more. Cindy Applebaum, market president and publisher of the *Albany Business Review*, moderated the discussion.

To continue to provide readers with the Industry Roundtable series during the current coronavirus pandemic, Hodgson Russ and the Albany Business Review *hosted a remote panel discussion. In light of the current market, the panel was limited to Hodgson Russ attorneys.*

MEET THE PANEL

GLEN DOHERTY
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About: Doherty represents employers and management in all aspects of labor and employment law

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About: Massaroni is a trial attorney with experience in many substantive areas, including complex commercial disputes, personal injury and product liability cases, class action litigation and employment matters

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What types of restrictive covenants apply in the context of employment, and what are the differences that distinguish them?

SCOTT PATON: There are three principal types of restrictive covenants in the context of an employer/employee relationship. The first is most commonly known as a covenant not to compete, or a non-compete agreement. The second is a non-solicitation covenant. The third is a confidentiality agreement.

CHRIS MASSARONI: A covenant not to compete generally restricts an employee from leaving his or her place of employment and then moving on to a competitive employer and working for that employer. This type of covenant generally provides a broad restriction against competition.

A non-solicitation covenant is more limited. It precludes an employee from leaving and then encouraging clients or customers of the employer to also leave and follow him or her to the next place of employment. So here, the restriction is limited to communications with the company's existing clients or customers, not with potential customers at large.

A confidentiality agreement simply protects the trade secrets and proprietary information of the employer. It is very often in place during the term of employment, such that the employee is restricted from using confidential company information for his or her benefit, or for the benefit of another. And it generally extends well beyond the termination of the employment.

Are these agreements enforceable? And what does that enforceability look like?

GLEN DOHERTY: Assuming an appropriate industry and an appropriate individual, if properly drafted, a restrictive covenant is fully enforceable. To be fully enforceable, a restrictive covenant must be drawn so as to be no broader than necessary to protect the employer's legitimate interests. It can include the protection of client goodwill, protection against competition by an employee in possession of unique skills, or the preservation of confidential information that, if disclosed, would render the employer at a competitive disadvantage.

The covenant must also be reasonable in geographic scope and duration. For example, it can't say "no competition within 10,000 miles and for the next 10 years." It needs to be reasonable in geographic scope and duration. This analysis often takes into consideration the nature of the employer's business and the duration of the employment relationship, and finally, the area or function in which the employee worked.

Are there past examples you can share without giving us company names or employee names, where there was a win in court, and one where it didn't turn out so well in court?

PATON: The areas of industry that the covenants impact are virtually limitless. For example, we've litigated cases enforcing restrictive covenants in the context of landscaping companies and hair salons. On the other end of the spectrum, we've handled cases involving neurosurgeons and sophisticated, learned professionals whose skills truly are unique. And everything in between.

MASSARONI: The circumstances where we see these restrictive covenants are more often circumstances where the employee is in a sales capacity or a customer relations service capacity. We see this with insurance agents and brokers quite often, and have had success on both sides of the claims.

PATON: One of the reasons we see these agreements in these industries is because the employee is interacting directly with a customer on behalf of his employer. The employee is being paid to build trust with that customer and to promote customer loyalty. That's goodwill. If the employer introduces that salesperson to a client, and pays the employee to develop that relationship, the employer has a legitimate interest in protecting that goodwill.

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When people leave one company to move on to another, is there an obligation for them to say, "I walk away having a non-compete clause in place?"

PATON: It is obviously best practice to be fully transparent with a potential employer, and to disclose the existence of the covenant. The new employer needs to have council review it and give advice about whether it's enforceable, and whether it's a fight worth having. More often than not, if it's a qualified individual, it's worth the investment in litigating the issue.

If the employee is not transparent, bad things can happen. We've seen instances where the individual does not disclose to the prospective employer the existence of a restrictive covenant. No employer wants to learn of a covenant after its employee has been sued, and an injunction is issued, preventing the individual from working with the new employer.

MASSARONI: It is best practice for the new employer to inquire because the new employer will be one of the targets of any claim by the former employer.

Can we dig a bit deeper into non-solicitation agreements?

DOHERTY: A non-solicitation agreement is directed at the specific behavior of a departing employee. The non-solicitation would say something like, "Do not approach. Do not solicit. Do not accept work from the same exact customers that the company put you in touch with when you were employed by the company."

PATON: Oftentimes, employers are tempted to go further than they really should. They'll put into place a non-solicit agreement that prohibits the employee from soliciting anyone who has ever been a client or customer of the employer – without regard as to whether the employee had any contact with the customer.

The problem with that is, if the departing employee only was exposed to, say ten of the employer's 100 accounts, that employee can only benefit from the goodwill of the employer for those ten. A properly drafted non-solicitation clause would tie the restriction to those accounts with whom the employee had meaningful contact. Because again, the employer has a legitimate interest in protecting the goodwill that it created through its investment of time and resources. Non-solicitation agreements can be incredibly effective and completely enforceable. They just have to be drawn the right way.

What industries would typically use non-solicitation agreements?

MASSARONI: Anyone who has customer contact could legitimately be bound by a non-solicitation agreement.

PATON: The contrast between non-solicits and non-competes would be this: Let's take the example of a neurosurgeon. A non-solicitation covenant for a neurosurgeon doesn't really make a lot of sense because a neurosurgeon is not out there ringing doorbells. But the skills of a neurosurgeon are unique, and in this context non-competes are effective and enforceable. The more unique the professional, the more likely that professional can be bound by a non-compete.

A non-solicitation covenant affects anyone in a profession or trade that has customer contact. It could be a sales professional or a design engineer or an IT professional. They might not have had face-to-face interaction with the customer, but they know that customer's needs. They were allowed to learn inside information about that particular client or customer. Even though that person was not in a sales capacity, if that person goes to a competitor, that competitor is at an advantage by knowing how to best win that client over because the employee was exposed to that confidential information.

These concepts overlap and tie together. That's a classic instance of where a non-solicit agreement doesn't need to be limited to a sales professional. Anyone who has gained inside information, for lack of a better term, concerning a client or customer can be insulated from soliciting the patronage of that client or customer.

What more can you tell us about confidentiality agreements and the obligations surrounding them?

MASSARONI: Confidentiality agreements are extremely common. They're used for persons who are going to be in a position where they will have access to important company information. They are a reminder to the incoming employee that he or she is going to have access to information that is extremely important to the company, and that it must be preserved in that fashion.

We have had cases where employees have been disloyal during the term of their employment and sought to engage in side deals, if you will, for their own personal benefit. Or, they have diverted confidential information in order to set up competing businesses as part of a plan to leave. This is engaging in competition with the company.

Many people don't recognize this, but the law implies a confidentiality requirement. Even in the absence of an executed confidentiality agreement between employer and employee, the employee nonetheless has a common law obligation to honor, respect

HODGSON'S TAKE

"Uncertainty breeds opportunity. The COVID-19 crisis is no different. The pandemic will result in increased employee mobility, as both employers and employees re-think their relationships and explore new opportunities. It is critical for employers and employees alike to develop an understanding of how restrictive covenants will impact that mobility."

SCOTT PATON, partner at Hodgson Russ LLP.

and adhere to the confidentiality requirements of the company, and to not use company information for his or her own benefit, or that of someone else.

DOHERTY: I often see a misuse of confidentiality agreements. Some employers use "form" agreements – agreements that are largely inapplicable and/or actually detract from that which already exists under common law (without an agreement). Confidentiality agreements must be tailored to the specific business and specific employee.

One quick example to hit my desk in the last 90 days: A client gives me a confidentiality agreement that it has historically asked employees to sign. I look at the agreement and see that it spends more than a half page describing the obligation to keep confidential patient information, patient lists, patient billing, and everything else related to HIPAA. The only problem: this was a manufacturing client that had no relation to the practice of medicine or the treatment of patients. The point is that employers need to be smart when they're using these agreements. Stay off the internet. Get one that works for your company and get one that doesn't take away that which is provided under common law.

MASSARONI: Another interesting thing we see on these confidentiality agreements is the issue of what is and what isn't confidential, what is and what isn't protected. The employer can seek to enforce and protect legitimate interests, and seek to enforce and protect against the disclosure of their trade secrets and confidential information.

PATON: When you have a true trade secret, the recipe for Coca-Cola, for example, clearly that's protectable. But then where does it end? A classic example that's somewhat outdated are the names in a phone book. That's public information. If you've got a customer list created from the names of folks who live in zip code 12207, that's not protectable. That's public information. On the other hand, if that information is then re-sorted or re-organized in a way that is tied to consumer preferences, income or other variables, that generic public list now becomes proprietary. It becomes protectable because it results from the employer's investment of resources to make that which used to be public and available, into something more private and protectable.

What about email addresses? Are they considered confidential?

MASSARONI: It depends on the type of information. With the power of the internet, it is very easy to find out where people live. You can do a search for tax records in various counties, deed records and whatnot. Therefore names and addresses are publicly available, and telephone numbers are also generally available. However, an email address quite often is generated and assigned by the employer. That's not necessarily public information, unless you go on the website for your employer and it has everybody's email address. But if it's a Gmail address that someone created on their own, that's not going to be publicly available. If an employee obtained that private email address through the employer's efforts, the employer has a right to declare it confidential and prohibit the employee from using it in competition.

Do employees typically receive anything for agreeing to such restrictions?

DOHERTY: In New York, every agreement must be supported by consideration (i.e., something of value). But in New York, a confidentiality agreement, a non-solicitation agreement or a restrictive covenant agreement can be supported by the continuing of employment. Continued employment will be the consideration given to the employees.

PATON: Often times you see, for example, stock option agreements, additional remuneration, bonuses and the like as enticements to get employees to agree to some of these restrictions. But it's not necessary.

Are there downsides to these agreements?

DOHERTY: Not if they're done correctly. Employees, especially at the executive level,

expect to enter into a non-compete, non-solicitation and/or confidentiality agreement. Upon separation, it is the employer's choice as to whether it wishes to seek employment.

MASSARONI: The primary downside to a non-compete is not based on a legal issue, but a recruiting issue. If an applicant or a new employee learned that he or she is going to be bound by an onerous post-employment covenant at employer 'A' but not at employer 'B', all else being equal, that applicant might choose to work with employer 'B'. Therefore, companies should be sensitive to the scope of these covenants.

PATON: If the covenant is not drafted properly, that can be a downside. Let's say you employ 500 individuals and every one of them signs the same boiler-plate restrictive covenant. If one employee leaves, litigates and establishes that the covenant is not enforceable, the remaining set of your employees would be better positioned to seek employment elsewhere. So, if you're going to use these things, make sure they're done right.

If an employee resigns, what can an employer realistically expect to achieve from these types of covenants?

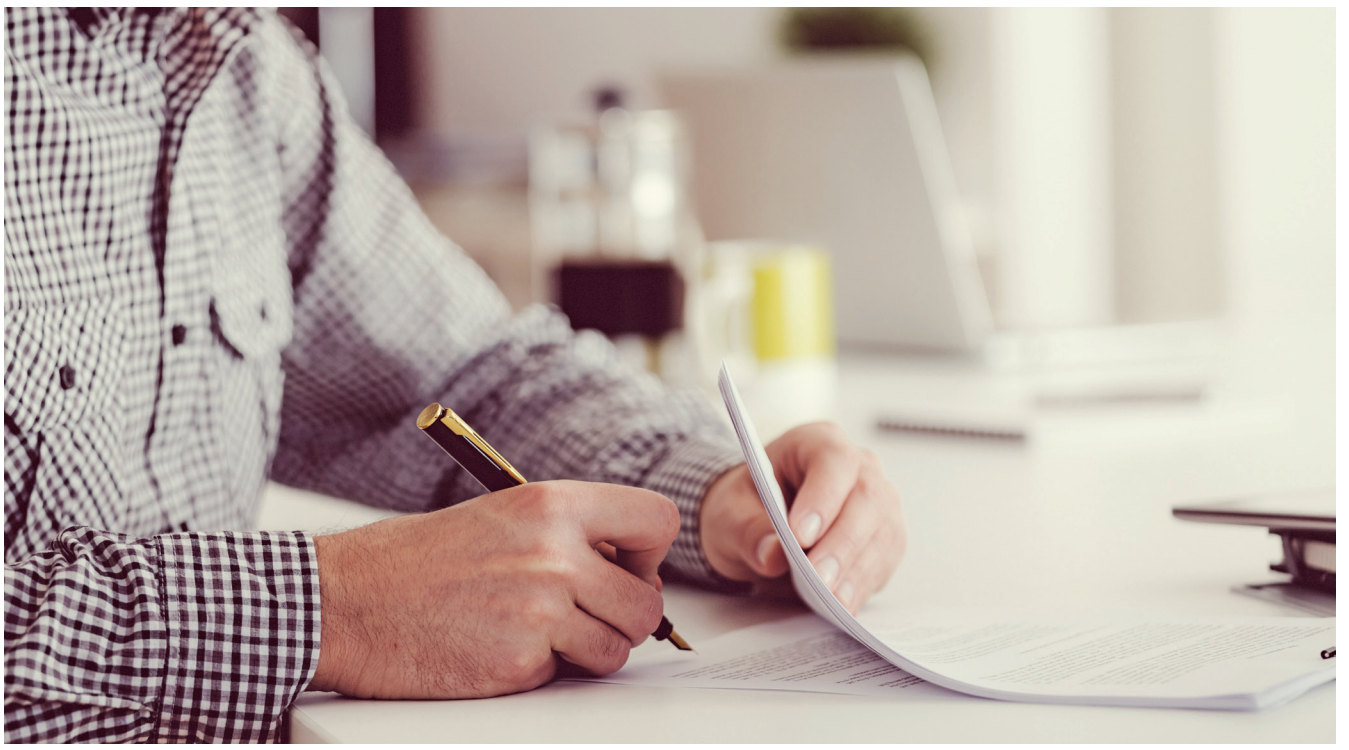
PATON: It depends on the type of covenant, and more often than not it depends on the circumstances that surround the employee's termination. Often times, the departing employee decides to use the company email account to send information to his or her personal account. That's inappropriate if what's being emailed is proprietary to the employer.

If that occurs, the employer is going to find out. When there's that type of misconduct, an employer is more likely than not to react by seeking an immediate injunction in the form of a Temporary Restraining Order, and to litigate in order to protect against the misappropriation of confidential information.

PATON: In Albany County, these cases are typically assigned to the commercial division judge, who is very well versed in the enforceability of restrictive covenants. An employer can reasonably expect to get some protection from a covenant that's drawn properly, especially when the employee commits some degree of misconduct.

MASSARONI: Most employees do the right thing. They understand what they've signed. These agreements guide the employee in what he or she is going to do in the future. If they have made a promise not to solicit the customers that they were introduced to at the employer, and they follow the agreement, life is great. There's a large benefit outside of litigation in having a very well drafted, specific, narrow agreement that employees are prepared to follow. This can be a powerful deterrent to unlawful actions by the employee. That's a great benefit without litigation.

Is it cost effective for an employer to sue to enforce a covenant?



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MASSARONI: We look at these on a case-by-case basis. We spend a lot of time counseling the client as to whether litigation may or may not be worth it. Assuming there is an enforceable document, and assuming there are pretty obvious signs of misbehavior by the employee, the employer must weighs the projected loss of business that could result if the employee is left unchecked.

Another analysis that employers go through is, "OK, this is one of 45 salespeople and it's the first one to engage in this kind of misconduct. Do I need to demonstrate to my employees that I'm going to protect my business by pursuing this one employee?" Sometimes there's value outside of the specific situation of deterring unfair competition.

Why have these types of covenants become more common?

MASSARONI: Employers want to protect their investments. Employers have two important assets. One is their skilled employees and the other is its customers. We see more of these covenants, or at least an effort to use these covenants, to protect and preserve both their employment base and their customer base. As this economy gets more competitive, we're going to see more employers trying to protect those interests.

Are you seeing any new trends regarding covenants?

DOHERTY: I've often seen a misuse of covenants. Employers get a document from a non-employment lawyer, off the web or from a trade association, and it is used to tie up very low-skilled, low-threat employees. It's a misuse. They're probably not enforceable in the first instance, but they're out there, and I often see letters threatening enforcement of a document that is not enforceable.

Every year there is some sort of legislative activity to address the overuse of restrictive covenants. My prediction is that New York will pass legislation in the near future that deems such agreements unenforceable against those making "X" or less.

Any final thoughts about areas we haven't touched on?

PATON: It's going to be interesting in the coming months to see the ripple effects of the coronavirus pandemic on our local and national economies. It's reasonable to expect that at the end of this process, there's likely to be increased employee mobility. Not only will there be layoffs and downsizing, but employees may decide to pursue new employment. The grass always appears greener somewhere else, and employees may want to seek opportunities to make more in salary and have less in the stock market, or get into a new employment situation with better health benefits.

This crisis is going to result in employees looking elsewhere, and for employers to more aggressively recruit talented folks. That, I think is going to feed into increased, or at least continued prevalence of these non-compete, non-solicit and confidentiality agreements.

DOHERTY: Employers need to be intelligent about the use of restrictive covenants, non-solicitation agreements, and confidentiality agreements. Employers need to specifically tether them to the employee or the employee group at issue. How often do we see that 500 employees of a business have signed the same agreement? Not everybody has a pressure point and imposes a threat of unfair competition. Employers need to spend the time to tailor these documents to the specific situation and not overuse them.

MASSARONI: Non-compete agreements are an important part of the arsenal that all employers must use in protecting company assets. These agreements have become more important, in part, because courts have enforced them when done correctly. Employers must be proactive about addressing their concerns up front, and then proactive if a disloyal employee leaves the company in a bad way, such as attacking or pursuing the customer base, or taking confidential information with them.

COMING UP

Industry Roundtable is an ongoing series of discussions with business leaders sponsored by Hodgson Russ. Look for the next Industry Roundtable discussion in the **May 22** edition on Immigration.

May 22
Immigration

June 19
Construction

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