Restrictive Covenants & Confidentiality Agreements: What You Should Know

By: Stephen L. Brodsky, Esq.
Moritt Hock & Hamroff LLP
sbrodsky@moritthock.com
(516) 873-2000

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Stephen L. Brodsky is an experienced commercial litigator who represents corporate and individual clients in all phases of litigation, from inception through trial (bench and jury) and appeal. He also counsels his clients to effectively resolve their disputes without litigation. He regularly practices before federal and state courts, arbitration tribunals, and administrative agencies. Mr. Brodsky has litigated high-stakes matters in courts across the nation, including at the federal appellate level. He has a broad practice and handles matters not only involving restrictive covenants and confidentiality agreements, but also matters involving, among other things, business torts and unfair competition, theft of trade secrets, shareholder and partnership disputes, fraud, breaches of fiduciary duty, securities, banking and complex breach of contract disputes. In addition to his practice, Mr. Brodsky frequently publishes on legal and business-related topics.

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Types of Restrictive Covenants

There Are Various Types:

Non-Compete Provisions: Prohibit engaging in or performing work for a competing business (often defined by product type and/or service) for a specific period of time in a geographic area or market. These are generally considered the most restrictive of restrictive covenants.

Non-Solicitation Provisions: Prohibit soliciting business from the company's current, prior and/or prospective customers for a specific period of time. They may also prohibit accepting or soliciting the business of such customers. These are frequently coupled with non-compete provisions, as less restrictive alternative protections, in the event the non-compete provisions are deemed unenforceable.

Types of Restrictive Covenants

Non-Solicitation of Employees/"Anti-Raiding" Provisions: Prohibit soliciting the company's employees. Usually are enforced to protect a company's investment in the training and development of its personnel. These may be enforced even in jurisdictions that are otherwise hostile to restrictive covenants.

Confidentiality Agreements: Prohibit the disclosure and/or use of information that is proprietary and/or confidential to the company's business, as well as the business of its customers. Protected information need not necessarily rise to level of a "trade secret" under applicable state law.

"Garden Leave" Provisions: Relatively new to United States from the United Kingdom and other European countries. The departing employee gives notice, remains employed during the notice period and cannot work for another company during a defined time period.

Types of Agreements That May Contain Them

Restrictive Covenants May Be Included In Various Agreements:

Employment Agreements: Restrictive covenants are most commonly found in employment agreements.

Stock Grant Agreements: They may also be included in stock grant agreements for stock options, restricted and performance shares. Such agreements are considered separate from, but related to, an employment agreement.

Types of Agreements That May Contain Them

Shareholder Agreements: Shareholders are often key employees who have extensive knowledge of a company's confidential property, trade secrets, and business plans. They usually have close relationships with a customer's decision-makers. Non-compete provisions in shareholder agreements are viewed as protecting and benefiting all shareholders by preventing any of the company's owners from using insider information to start a competing business or to work with a competitor.

Severance Agreements: A severance agreement sets forth the respective rights and responsibilities of the parties in the event of termination. The agreement specifies any severance pay and/or benefits package and the conditions under which such pay and/or benefits will be provided or withheld.

General Considerations

Multiple Factors Are At Issue:

Protecting against restraints on trade and employment.

- Public policy acknowledges the benefits of free trade and employee mobility.

Protecting the legitimate interests of the employer.

- An employer/company has its own legitimate interests which are entitled to protection, including its customer relationships, good will, investments in personnel and proprietary and/or confidential information.

General Considerations

Protecting the freedom to contract.

- States also value the right of persons to freely enter into contracts.

The law varies significantly state by state.

- Applicable law may be based on governing state statutes, common law or combination of both. The law varies state-by-state.

- Courts also vary in their enforcement of restrictive covenants

- Must be aware of state legislative developments.

General Considerations

Scope and reasonableness of restrictions.

- Statutory frameworks and presumptions as to reasonableness?
- Case-by-case, fact-specific analysis as to reasonableness?
- Specific considerations based on type of industry at issue? E.g., healthcare/medical industry.
- Specific considerations based on type of employee?
    - Senior executives and key employees in sales, strategy, development, etc.
    - Unskilled employees.

Choice of law and/or forum selection clauses.

- Include a choice of law clause?
- Include a forum selection clause for disputes and/or enforcement?

State Statutory Frameworks

Check For Applicable State Statutes:

Certain states have enacted statutes that provide a framework that governs the enforcement of restrictive covenants in their jurisdictions. Such statutes may identify time periods or geographic boundaries that are *per se* unreasonable or, conversely, "reasonable," or "presumptively reasonable."

Other state statutes include technical requirements for enforcement.

Others have moved away from a prior public policy against restrictive covenants with statutes that allow more leeway.

State Statutory Frameworks

Examples:

- ***Georgia:*** *See* O.C.G.A § 13-8-50, *et. seq.* (changes prior public policy against restrictions, allows courts to evaluate non-solicitation and non-compete agreements separately, identifies key personnel, enhances non-disclosure provisions, defines what is confidential and/or valuable information, makes 2-year restriction presumptively valid).

- ***Texas:*** *See* Tex. Bus. & Com. Code, §§ 15.50 and 15.52 (restrictive covenants are enforceable only if entered into "ancillary to or part of an otherwise enforceable agreement," allows restrictions in medical field with specific caveats).

State Statutory Frameworks

- ***Oregon:*** *See* 2017 O.R.S. 653.295 (non-competes are voidable unless either the employer informs the employee, at least two weeks prior to starting employment, that a non-compete is a required pre-condition of employment and provides the agreement or the agreement is entered into in connection with a bona fide advancement during employment; employee must be an executive, administrative or professional exempt from overtime requirements, and have access to trade secrets or similar information).

- ***Missouri:*** *See* R. S. Mo. 431.202 (covenants of up to one year following the termination of employment are conclusively presumed to be reasonable).

- **Florida:** *See* 2018 Fla. Stat. § 542.3335(1)(d)-(e) (setting forth the duration and scope of restrictive covenants that are *per se* reasonable or unreasonable).

State Prohibitions And/Or Limitations

Check For Bans Or Restrictions On Enforceability:

Certain states prohibit nearly all non-compete agreements, subject to very limited exceptions. They may still enforce certain non-disclosure agreements (for example, if the information at issue is akin to a trade secret) and non-solicitation of employee agreements ("anti-raiding" agreements). The most well-known such state is California. By statute and as a matter of public policy, California prohibits nearly all non-competition agreements.

Others states impose strict requirements, usually through statutes, and rarely uphold non-compete agreements. These states may allow non-solicitation agreements, however.

States Prohibitions Or Limitations

Examples:

- ***California:*** *See* Cal. Bus. & Prof. Code § 16600 (imposes general prohibition on non-compete and non-solicitation agreements); § 16602.5 (listing exceptions, such as the sale of a business, including asset purchases). *See, e.g., Edwards v. Arthur Andersen LLP,* 44 Cal. 4th 937, 946 (2008) (discussing California's policy that restrictive covenant agreements are unenforceable on the grounds that they prevent employees from engaging in their chosen profession or trade).

- ***North Dakota:*** *See* N.D.C.C. § 9-08-06. ("Every contract by which anyone is restrained from exercising a lawful profession, trade, or business of any kind is to that extent void," except in connection with the sale of a business or partnership dissolution).

States Prohibitions Or Limitations

- ***Colorado:*** *See* Colo. Rev. Stat. § 8-2-113(2) (restrictive covenants are void); § 8-2-113(a)-(d) (listing exceptions related to the purchase or sale of a business, the protection of trade secrets, the recovery of training expenses employed for less than two years, or executives and their professional staff).

- ***Oklahoma:*** *See* 20 Title O.S. 2001 § 219A (an employee "shall be permitted to engage in the same business as conducted by the former employer or in a similar business … as long as the former employee does not directly solicit … the established customers of the former employer." Any agreement in conflict with this policy is "void and unenforceable").

The Majority Of States - "Reasonableness" Rule

Most States Follow The “Reasonableness” Rule:

The majority of states will enforce restrictive covenants to the extent they are "reasonable" under the circumstances.

Courts in these states will engage in a fact-specific, case-by-case analysis as to the reasonableness of the restriction.

Other states have enacted statutes which provide "presumptions" or other guidelines as to reasonableness for courts in their jurisdictions to follow.

The Majority Of States - "Reasonableness" Rule

The Reasonableness Test:

Generally, a restrictive covenant will be held as reasonable and will be enforced if:

1. It is no greater than is required for the protection of the employer's/company's legitimate business interest;
2. It does not impose an undue hardship on the employee; and
3. Is not injurious to the public.

See, e.g., BDO Seidman v. Hirschberg, 93 N.Y.2d 382 (1999).

The Majority Of States - "Reasonableness" Rule

Legitimate Business Interest:

- The following have been found to be legitimate and protectable business interests:
  - Proprietary and/or confidential information (including trade secrets);
  - Customer relationships and non-public contact information;
  - Customer business operations;
  - Goodwill; and
  - Investments in workforce.

The Majority Of States - "Reasonableness" Rule

Factors For Protectable Interests:

Generally, the greater the time, effort or resources expended by an employer/company to develop a customer relationship, the more likely a court will find a legitimate interest in protecting the customer relationship. These are fact-dependent determinations.

Protectable interests may also be found where:

- The former employee built relationships with the customers using the employer's resources;
- The employer/company devoted substantial time and effort for projects that were tailored to the specific needs of its customers; or
- The employer/company invested substantial time and money in maintaining staff dedicated to employee representatives who address the needs of its clients.
- New York courts may consider whether the services of the former employee are “unique” or “extraordinary.”

The Majority Of States - "Reasonableness" Rule

Factors:

Restrictive covenants will typically be enforced when they are:

- Necessary to protect the employer's or company's legitimate interest;
- Reasonable in geographic scope;
- Reasonable in duration;
- Not unreasonably burdensome to the employee; and
- Not harmful to the public at large.

The Majority Of States - "Reasonableness" Rule

Geographic Scope:

Courts will consider the particular facts and circumstances of each case to determine the reasonableness of the geographic scope of a restrictive covenant.

A covenant is likely to be considered reasonable if the restricted area coincides with the location of the employer's/company's customers or clients.

Where a covenant covers the area in which the former employee established significant contacts during his or her term of employment, the scope will also usually be held reasonable.

The Majority Of States - "Reasonableness" Rule

New Global Economy:

Courts historically viewed a broad geographic scope, or the lack of any geographic scope, as nearly *per se* unreasonable.

However, with the current global and internet-based economy, geographic boundaries have become much less significant, and at times, meaningless.

- *See, e.g., Victualic Co. v. Tiernan,* 499 F. 3d 227 (3d Cir. 2007) (stating that "a *per se* rule against broad geographic restrictions would seem hopelessly antiquated…."); *Natsource LLC v. Paribello*, 151 F. Supp. 2d 465, 471, 471-72 (S.D.N.Y. 2001) (observing that broad geographic restrictions are appropriate where the nature of the company's business requires it).

The Majority Of States - "Reasonableness" Rule

Courts are increasingly willing to find a restrictive covenant with a broad geographic scope (or with no boundary whatsoever) reasonable to the extent they restrict conduct with respect to an employer's/company's prior, current or prospective customers.

Despite the globalization of the economy, courts may still require geographic specificity depending on the industry and market at issue.

Examples:

- Louisiana (limited to where the employer conducts business);
- South Dakota (requires the parties to specify the locales in which the covenant applies);
- Georgia (limiting to where the employee was actually working); and
- Texas (same).

The Majority Of States - "Reasonableness" Rule

Temporal Duration:

Case-By-Case, Fact-Intensive Analysis

When a state does not have an applicable statute, state common law will govern.

Courts in most states routinely uphold temporal restrictions of up to one year. Courts in many states often uphold restrictions up to two years if the restrictive covenant is otherwise reasonable as to geographic scope. In other jurisdictions, such as New York and Michigan, courts have commonly upheld temporal restrictions up to three years.

The Majority Of States - "Reasonableness" Rule

Statutory Presumptions Or Guidelines As To Time

Certain states define by statute what constitutes a "presumptively" reasonable or, conversely, “unreasonable,” time period. Other states have blanket statutory prohibitions against restrictions that are longer than certain time periods.

As noted below, practitioners should be mindful of amendments to and/or changes in such statutes. Developments are always on-going.

The Majority Of States - "Reasonableness" Rule

Other Factors Courts May Consider:

- The length of time the employee had been employed when termination occured.
- The nature and amount of consideration rendered in exchange for the covenant.
- The circumstances of the employee's departure (voluntary or involuntary).
- The degree to which the employee had access to high level company strategic, proprietary and/or confidential information.
- The business cycle of the industry at issue.

The Majority Of States - "Reasonableness" Rule

Confidentiality Agreements:

A confidentiality agreement prevents a former employee from disclosing or using the employer's/company's proprietary and/or confidential information (either as to its own business or the business of its customers) that he or she obtained during the course of his or her employment and/or association with the company.

The information at issue need not qualify as a "trade secret" *per se*. It must be confidential and unavailable through public sources.

Courts will typically consider whether and how the employer/company sought to keep such information protected and confidential.

The Majority Of States - "Reasonableness" Rule

The Industry Matters:

When evaluating non-compete agreements, courts will consider the specific industry and profession at issue, and the resulting public interest, if any.

Healthcare/Medical Industry

Certain states have enacted statutes that render non-compete agreements in the healthcare/medical industry as unenforceable.

Other courts apply a stricter scrutiny when analyzing the temporal and geographic scope of a non-compete agreement, citing the patient-physician relationship and/or drawing upon state antitrust statutes.

Other courts simply apply the same standards that are applicable in the commercial context generally.

Industry-Specific And "Profession" Considerations

Examples:

- State statutes prohibiting non-compete clauses in physicians' contracts. *See* Colo. Rev. Stat. Ann. § 8-2-113(3) (2003); Del. Code Ann. tit. 6, § 2707 (1993); Mass. Gen. Laws Ann. ch. 112, § 12X (1991).

- Courts interpreting state antitrust statutes as prohibiting non-compete agreements involving physicians. *See, e.g., Gauthier v. Magee*, 141 So. 2d 837 (La. Ct. App. 1962); *Spectrum Emergency Care, Inc. v. St. Joseph's Hosp. & Health Ctr*., 479 N.W.2d 848 (N.D. 1992).

Industry-Specific And "Profession" Considerations

- Certain courts, while not endorsing a ban, strongly disfavor such non-competes, due to the nature of the patient-physician relationship and the public interest. *See, e.g., Intermountain Eye & Laser Ctrs., P.L.L.C. v. Miller,* 127 P.3d 121, 127 (Idaho 2005) (citing cases); *Murfreesboro Med. Clinic, PA*, 166 S.W.3d 674, 683 (Tenn. 2005).

- Other courts apply ordinary commercial standards to the healthcare/medical industry. *See, e.g., Goodman v. New York Oncology Hematology, P.C.,* 101 A.D.3d 1524, 1526, 957 N.Y.S.2d 449, 452 (3d Dept. 2012) (citing *BDO Siedman* standard); *Suffolk Anesthesiology Assoc., P.C. v. Verdone,* 2009 N.Y. Misc. LEXIS 6887, at *10 (N.Y. Sup. Ct. Suffolk Cnty. Sept. 28, 2009) (same), *aff'd*, 74 A.D.3d 953, 903 N.Y.S.2d 91 (2d Dept. 2010); *Rasch v. Toccoa Clinic Med. Assocs.*, 253 G.A. 322, 325, 320 S.E.2d 170, 172 (Ga. 1984); *Raymundo v. Hammond Clinic Ass'n*, 449 N.E.2d 276, 279 (Ind. 1983).

Industry-Specific And "Profession" Considerations

Salespersons

The unique relationship that salespersons have with customers has led certain courts to give deference to the employers when determining the enforceability of non-compete agreements applicable to salespersons.

Former employers can be especially harmed by salespersons, because the salesperson is often the company's most direct and/or significant point of contact for the customer.

Salespersons are not normally considered "professionals." Courts, however, have found instances where the services of a particular salesperson were "unique," thereby justifying enforcement.

Industry-Specific And "Profession" Considerations

Independent Contractors

Independent contractors are not necessarily considered employees of a company. Nonetheless, courts have, at times, been willing to enforce restrictive covenants against independent contractors.

In such cases, the courts analyze the nature of the ongoing relationship to determine if it provided sufficient consideration to support the restrictive covenant.

New Developments

Garden Leave Provisions:

- Relatively recent import from United Kingdom and other European countries.
- Most commonly found in employment agreements.

What They Typically Require

- Requires the departing employee to provide notice of resignation (typically between three and six months prior to departure).
- The employee remains employed during the notice period, receives full salary and other benefits, but after giving notice, is not required to perform any further services (or may perform only very limited services) for the company.
- The justification is that, because the employee remains employed by the company, he or she continues to owe a duty of loyalty to the employer and is not free to work for any other company.

New Developments

Relatively Little Case Law Guidance:

Garden Leave provisions have been infrequently challenged in court, possibly because they are still relatively new to the United States.

Conflicting Decisions On Enforceability:

- *See, e.g., Bear, Stearns & Co. v. Sharon,* 550 F. Supp. 2d 174, 178 (D. Mass. 2008)(declining enforcement on equitable grounds, stating "[b]ecause the effect of specific performance in this case would be to require the defendant to continue an at-will employment relationship against his will, it is unenforceable in that manner"); *Waldron v. Mendelson*, 2017 Pa. Dist. & Cnty. Dec. LEXIS 5898, at *33 (Pa. Ct. Comm. Pleas. May 5, 2017) (holding that "[t]he temporal restriction imposed by the Garden Leave Provision … is reasonable under Pennsylvania law… [where the employee] continued to receive compensation and benefits during the restricted period").

New Developments

Statutory Developments:

Certain states have enacted new laws (or amended their existing laws) which bear on the enforceability of restrictive covenants in their jurisdictions. Other states have proposed bills that are currently pending enactment.

Examples:

- ***California:*** Enacted Labor Code Section 925, which prohibits employers from entering into choice of forum or choice of law agreements with California workers. It does not apply to agreements entered into before Jan. 1, 2017, or to employees represented by counsel when negotiating the agreement.

- ***Colorado:*** Amended C.R.S. § 8-2-113(2) as it applies to physicians and not prohibits the recovery of damages against physicians who treat patients with "rare disorders".

- ***Idaho:*** Repealed I.C. § 44-2701, *et seq.,* eliminating a rebuttable presumption of irreparable harm for departures of "key employees".

New Developments

- ***Illinois:*** Enacted the Freedom To Work Act, 820 ILCS 90, *et seq.,* prohibiting restrictive covenants for "low-wage" employees earning the greater of $13 per hour or the federal minimum wage.

- ***Nevada:*** With NRS § 613.200, Nevada now requires employers to offer "valuable consideration" (an undefined term) for an enforceable non-compete and rejected the "red pencil doctrine" (by which courts could invalidate an entire non-compete if some portion of the covenant is unenforceable.)

- ***New Mexico:*** Expanded the non-compete prohibition for medical professionals in N.M.S.A. § 241i-1 to include certified nurse practitioners and mid-wives, and prohibited selection of forum and choice of law clauses.

New Developments

- ***Oregon:*** Expanded its prohibition as to non-competes, anti-raid agreements and customer non-solicitation agreements to home care workers.

- ***Utah:*** Expanded non-compete protections to workers in the broadcasting industry implemented a salary threshold.

New Developments

State AG Investigations Of Franchisors
Using Non-Competes Against "Low Wage" Workers:

In July 2018, State Attorneys General in ten states, including New York, New Jersey, Massachusetts, California and Illinois, announced investigations of fast food franchisors for their use of non-compete and "no-poach" agreements to restrict the ability of low-wage workers to obtain better paying employment with another franchise. *See* "U.S. States Probe Fast Food Deals Not To Poach Workers," July 9, 2018 (Reuters).

Takeaways

Know The Law In The Governing State Jurisdiction.

Statutory framework, common law, or combination of both?

- Complete prohibition?
- If so, what are the exceptions?
- Presumptions as to the reasonableness of geographic limitations and/or time durations?

Reasonableness, fact-specific test?

- What are the geographic scopes and time durations that courts in the state typically enforce?
- Are there exceptions the courts follow?

Takeaways

- When is national scope or no geographic scope appropriate?

- What other facts do courts find significant when assessing a restrictive covenant?

- What facts do courts find significant when balancing the employer's/company's interest against the interest of the employee and/or the public?

Include A Choice Of Law Clause And/Or Forum Selection Clause?

Such clauses provide clarity and certainty.

A company operating in an "employer-hostile" jurisdiction may consider selecting the more favorable law of another state, but only if there is a reasonable basis for doing so (e.g., where the company is headquartered, does substantial business or is incorporated).

Takeaways

Know The Industry And Public Policy Considerations.

For example, the healthcare/medical industry.

Stay Abreast Of State Legislative Developments.

Know the law currently in effect in the state and potential amendments that may be enacted.

Check If The Employer Or Company Operates In Multiple States.

Companies may need multiple agreements to comply with the laws of each state in which it operates, if choice of law is not possible.