Non-Competes and Other Restrictive Covenants

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Melissa Pheterson: Hi, my name is Melissa Pheterson from Harris Beach, and I'm your host for today's episode. I'm joined by Dale Worrall, leader of the Harris Beach Business and Commercial Litigation practice and Scott Piper a partner in the firm's Labor and Employment practice and chair of the firm's Risk Management Committee. Today we're discussing the world of non-compete agreements and other restrictive covenants, their usefulness to employers, how they should be drafted, enforceability, and when businesses should pursue litigation. Scott and Dale, welcome to the podcast!

Dale Worrall & Scott Piper: Thanks Melissa. Thank you for having us.

Melissa Pheterson: To start, can you each briefly share your area of focus at Harris Beach and the lens through which you view and approach non-competes and restrictive covenants?

Scott Piper: Sure, let me start off here and then turn it over to Dale. As a labor and employment attorney, I help employers draft the agreements that are ultimately litigated. I also help employers who need to enforce an agreement on the way out the door or perhaps remind an employee about the terms of an agreement on the way out the door. Also, if an employer wants to hire an applicant or an employee and say that applicant or employee presents a non-compete to them, the employer has to decide, can I still hire them? If I hire them, what steps should I take? And also, Dale and my practices overlap just a little bit because on occasion I also do go into court and litigate these agreements. Whether its prosecuting the agreements or defending against someone trying to enforce them.

Dale Worrall: So, as a litigator, I will obviously look at these agreements from a litigation perspective. I will typically get a call from a client when there is some sort of problem, some sort of dispute, and I will look at the agreement. First, from enforceability standpoint, you know, are we dealing with a low level employee, are we dealing with a special unique or extraordinary employee, is the agreement reasonable in scope, all of those types of things. Scott and I will actually work together, bounce questions off of each other, in that respect. But even bigger than the enforceability of the agreement, I look at and ask the client about their

overall objectives. And what I mean by that is how much damage is caused by the alleged breach of this agreement, because that's critical to the clients' ultimate decision whether to pursue litigation or pursue some other avenue. Is this the secret sauce so to speak where the clients entire business is on the line or is this a low level employee where we can pursue other avenues?

Scott Piper: Let me just jump in real quick. I think the objectives of the employers is a very important point that we're probably going to talk about a little bit more today. That is a primary concern in my world in drafting the non-competes as well. The first question I always want to cover with an employer/client is: okay, what are your objectives with this agreement, what are you seeking to protect?

Melissa Pheterson: Can you explain what non-compete agreements and other restrictive covenants entail? Kind of an overview and how they are useful to employers?

Scott Piper: Sure, let me take a stab at this. The term non-compete and non-compete agreements many times is used fairly generically to talk about restrictive covenants in general. I tend to look at restrictive covenants in say tiers. The most restrictive tier is the non-compete agreement which may prohibit an employee for, I don't know, a year, two years, three years, five years, from competing in the industry that the employer is in. They can't do anything in the industry the employer is in. That is the most restrictive covenant out there. You can ratchet it down a little bit, perhaps talk about non solicitation of clients provisions. Maybe an employer doesn't need a restrictive covenant or maybe that's a little bit overbroad, so maybe a non-solicitation of client's provision where the employee agrees for say a year, some period of time, not to solicit or perhaps not to do business with the employer's clients. There's a lot that goes into the decision of what level you're going to use and how broad the restriction is on each level, but those are the primary agreements that a lot of employers will think about when you talk about non-competes. You can also in the world of restrictive covenants, you should also consider and talk about confidentiality agreements, non-disclosure agreements. Maybe a strict non-compete or even a non-solicitation of client's provision is not necessary to protect your business. Instead, you want to protect certain information, maybe as trade secrets or other confidential information. So, maybe you have the employers or the employees sign a confidentiality agreement or nondisclosure agreement where they agree not to use or disclose certain confidential information or trade secrets. So, again when you're talking about restrictive covenants, I tend to look at them as in tiers of restrictiveness. Non-compete, non-solicitation and non-disclosure/confidentiality provisions.

Melissa Pheterson: What should employers keep in mind when they're drafting these non-competes and other restrictive covenants? What should they include, what qualifies as reasonable provisions or limitations?

Dale Worrall: So, I'll take the first stab at this and I can tell you from a litigation perspective, you know, aside from the scope and all the limitations, the first thing that I

always look for is a jurisdiction and venue provision and an attorney's fees provisions, and I'll explain why. A venue provision is extremely important when we're dealing with non-competes because I want all my clients to be litigating on their home field so to speak. The client is here in Monroe County; I want them to be in the Monroe County Courts. This type of litigation can be extremely intense. You usually start with a preliminary injunction motion, perhaps some expedited discovery, some expedited depositions, document demands, where folks are litigating very intensely at the early stages of the litigation. When you do this, all the depositions will be in your hometown or your home city, you're not traveling to California, you're not traveling to Chicago or anything like that and that bears upon expense, it bears upon disruption to the company, it bears upon a lot of things. So, that's probably one of the first things that I'll look at when I open up one of these agreements is the venue provision. Attorney's fees, is the client going to bear the expense of this, because in New York the only way you can get attorney's fees is if it's in the contract, so if the attorney's fees provision is not in the contract, you know that the client is going to bear the expense for this whether they win or lose. If there's an attorney's fees provision in the contract, there's a chance that they may recover those attorney's fees, so that would be the second thing that I really look for from a litigation perspective. Once I look at those things, then we can get into the contract a little bit deeper in terms of limitations and scope and durations and things of that nature.

Scott Piper: Those are all key points that I also discuss with employers when we're talking about, do they need an agreement and if they do, what provisions do we put in the agreement when we draft it? I can't emphasize enough the importance of the attorney's fees provisions. So many times decisions are made about what you're going to do in a non-compete case based on, okay, there's a chance if I lose I might have to pay the other parties attorney's fees? That is a piece of leverage that can be very important in these cases if you actually have to enforce one. So, when it comes to drafting what do you keep in mind or what do you discuss with the employer? I think, most importantly, employers should understand that one size does not fit all when it comes to these agreements. So many times I have clients come to me with agreements maybe they have just printed off the internet. That usually is not a good idea. It has to be customized to the employers needs. So, much like Dale said at the beginning of this podcast, one of the most important things, is what is the employers objective? What are you looking for, what are you looking to protect when it comes to these agreements? There are a number of ways to protect what you are seeking to protect, we can put provisions in that maybe you haven't thought about, whether it's the attorney's fees provision or we offer employers offers like do you want to put a provision in an agreement that says the employee upon separation of employment is required to present your agreement to any subsequent employers? That way you know that the new employers on notice of the restrictive covenants. That's something to think about. Inevitability, in discussing with employers what provisions do you want in the agreement, do you want the most restrictive non-compete provision in your agreement? Is it necessary? Dale might have some thoughts on this but one of the discussions we always have is in New York, courts will, what's called

blue pencil, in most circumstances, the courts will blue pencil an agreement that's over broad. Basically, that means they could modify and strike out a provision that is over broad, say the non-compete and enforce the rest of the agreement. If that's the case, does the employer want to include that just as a deterrent? Many times, employers when considering what they want to put in their agreement, will make decisions based on deterrent effect, not necessarily whether somethings ultimately enforceable down the road. A lot of decisions go into deciding how to draft, what to put in a restrictive covenant agreement. Again, most importantly, one size does not fit all, they shouldn't just print one off the internet, you have to talk about what are you really trying to protect.

Melissa Pheterson: Coming at this from a slightly different angle, if an employer is presented with a non-compete or other restrictive covenant, what should he or she look out for?

Scott Piper: I regularly get agreements from clients who are about to hire an employee, or they've hired an employee and the employee says, well I forgot to tell you I have this non-compete with my former employer. So, if you haven't hired the employee yet, then you have to factor that into your decision. From a strictly, are you going to be violating the agreement terms standpoint, what position are you hiring them into? Many times we're talking about sales people. Not all the time but many times we are talking about sales people. Are you hiring them to work in the same position they worked in at the prior employer? Are you hiring them because they have certain customer contacts? Were those customer contacts provided to them by the prior employer? And what does the prior employers agreement say of course? Sometimes, when I get these agreements it's apparent that our client can hire them into a position and still comply with the terms of the agreement with the former employer. Other times, the reason they're hiring them is because they're going to put a dent in the former employers (competitors) business and it may violate certain terms of the agreement. Then the employer, our client, has to make a business decision. How much risk are they going to take? Probably a lot in like in a litigation context, we also discuss how motivated will the former employer be to enforce the terms of this agreement. Many times, the strict enforceability of the agreement, while important, is not determinative. Many times, it's, how likely is the former employer going to be to sue this out because you know that's going to cost tens of thousands of dollars to defend, even if you're successful. And if the former employer is a massive company, then you might want to think twice because you might find yourself in some significant litigation.

Dale Worrall: I couldn't agree more. When we get these types of questions, the first thing that we look at and evaluate is the motivation of the other party. How motivated are they going to be to seek, to enforce this non-compete? Are they deep pocket, is our client likely going to get embroiled in deep expensive litigation, or is this a situation where we don't think litigation is on the horizon. So it's really a cost benefit analysis for the client when they are presented with a non-compete. How valuable is this potential employee versus well, how much litigation costs are we possibly going to incur if we hire this person. And then I build into that

discussion all the things that we just talked about. Jurisdiction and venue, attorney's fees, provisions, all those types of things are built into this discussion because they all bear upon costs and the stress of litigation.

Melissa Pheterson: And Dale, building on that, when should businesses decide to pursue litigation and kind of analyzing to what extent non-competes are enforceable in New York State?

Dale Worrall: My advice to clients and the first thing that I always try to evaluate is the clients potential damages as a result of an alleged breach of a non-competition agreement or other restrictive covenant. Does this truly involve a trade secret where the entire business of our client is at risk or is this a low level employee that's really not going to cause much damage to the company is the breach is allowed to happen? Everything flows from that analysis. So that's what we look at.

Scott Piper: Let me just jump in and add; I'm wondering Dale, do you ever see companies wanting to enforce an agreement to make an example of a former employee?

Dale Worrall: So I hear that all of the time. And we talk about different strategies about how to make an example of someone because news does travel fast within an organization and sometimes that can be accomplished by a mere letter writing campaign as opposed to full blown litigation but I always encourage clients not to pursue litigation just to make an example out of someone, just to discourage other folks from leaving and seeking employment somewhere else. You really want to pursue litigation in those situations where your company is at risk of harm, damages, real damages. The secret sauce, so to speak, is out in the open. And that's where you really want to get into that litigation and seek to protect the core of your business. If it doesn't involve that it could end up being just that a cost benefit analysis doesn't make sense.

Melissa Pheterson: I know in one of our previous conversations you had said not to let emotion drive the decision whether to litigate, so that ties in.

Dale Worrall: Absolutely, especially when you're dealing with a smaller company, everyone knows everyone, when someone leaves, it's viewed as a betrayal to the company, it may not cause the company a lot of damage so to speak, but that betrayal generates emotion and that emotion drives the litigation. I try to determine if that's what driving the clients decisions at an early stage and dissuade them from pursuing expensive litigation if the litigation is really rooted in emotion as opposed to true damages.

Melissa Pheterson: If the non-compete is made in conjunction with an acquisition, does this impact enforceability?

Scott Piper: That's a good question, Melissa, it does. What is the general rule at least in New York, and let me just say, when it comes to non-competes, its very state specific, I know this is not exactly the question that you asked, I'll get to that in a second,

but I wanted to make the point, you know, non-compete law is a state by state law and non-compete may be enforceable in one state and not enforceable in another. For example, California, and we've got a number of clients with facilities in California, they want to have those employees in California sign non-competes. Non-competes, even non-solicitation of clients provisions in California are strictly prohibited by law. So I just wanted to make that point, everyone listening should understand that it's a state by state determination. Now, with respect to acquisitions, in most states, especially in New York, if there is a non-compete entered into as part of an acquisition, it's generally much easier to enforce those than a non-compete in the context of employment with a typical at will employee. Generally, courts will see that transaction as much more arm's length. Both parties will probably have attorneys representing them and the party that is typically signing the non-compete is receiving many times hundreds of thousands of dollars, maybe millions of dollars as a result of the acquisition. Courts are much more likely to enforce non-competes, other restrictive covenants in those circumstances and people that sign those, businesses that sign those, need to be aware of that.

Melissa Pheterson: My last question is: a reasonable expectation of cost to have outside counsel prepare a non-compete or other restrictive covenant. Do we want to go there?

Dale Worrall: Well, we do and we don't. From my perspective, the cost of having outside counsel prepare a non-compete is worth it and Scott can talk more to this because I don't draft them but I would think it's a minimal expense. But the real cost here comes in the enforceability in the non-compete if you get into litigation. Once you get into litigation the client is going to have, if you're the plaintiff, the burden of proving and enforcing the non-compete or the restrictive covenant. Depending upon the evidence, depending upon the particular facts and circumstances of the case, this could be easy to do, this could be very difficult to do, which bears again, on expense and as you can tell, one of the common themes through what I've been saying today is the expense because it's so important to the litigation analysis. I've had cases where it's been a couple thousand dollars, we engage in a letter writing campaign, I've also had cases where we get into the expedited discovery, depositions, preliminary injunctions motions, full trial, where it costs hundreds of thousands of dollars to enforce a non-compete. So the expense upfront of drafting a solid agreement is completely worth it from my perspective but even if you have a very solid, enforceable agreement, if there is a breach or an alleged breach, you still have to weigh the cost of potential litigation. Where is that litigation going to take place, going back to the jurisdiction and venue topic, attorney's fees provisions, all of those things build into that analysis.

Scott Piper: Let me just add, I agree with Dale, I think the cost upfront is typically minimal, cost on the backend, if you have to try to enforce one, it will dwarf that. The way I would look at this question though Melissa, is not what is the cost of drafting it but what is the cost to the business of not drafting it? Really, from a business perspective, I can't tell you how many times clients have come to me, an

employee who they have introduced to their most important client, they've been working there, five years, ten years, they decide to leave, they take that client relationship which you gave to them, to a competitor, and our client doesn't have any kind of restrictive covenants in place, you are in a tough position and that could do some major damage to your company. So, the way I look at it, most times is not what is the upfront cost of drafting this but is what is the cost of not drafting this to your business if things go south down the road?

Melissa Pheterson: Great, is there anything you'd like to explore further based on what we've covered today?

Scott Piper: I would just like to emphasize, there is no cookie cutter approach to non-competes, there is no one-size fits all. I encourage any employers listening to this to really think about what their business needs are, what do they want to protect. Is there important information, trade secret information, other confidential information? Most likely, maybe a client relationship or maybe even a broker relationship or a referral source relationship that is key to your business, what happens if that walks out the door. If you don't have any protection for that, you need to think long and hard about maybe having outside counsel prepare a restrictive covenant agreement and rolling it out to your employees. It could be vital, you would hate to look back in a few years if the worst case scenario happens and think what if I had just invested in a restrictive covenant agreement and rolled it out, I'd be in a much better position to protect my business.

Melissa Pheterson: I'd like to thank Dale and Scott for joining us today. For more information visit www.HarrisBeach.com/laborandemployment and www.HarrisBeach.com/bclit. You'll also find Dale and Scotts contact information so you can reach out with any questions.

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