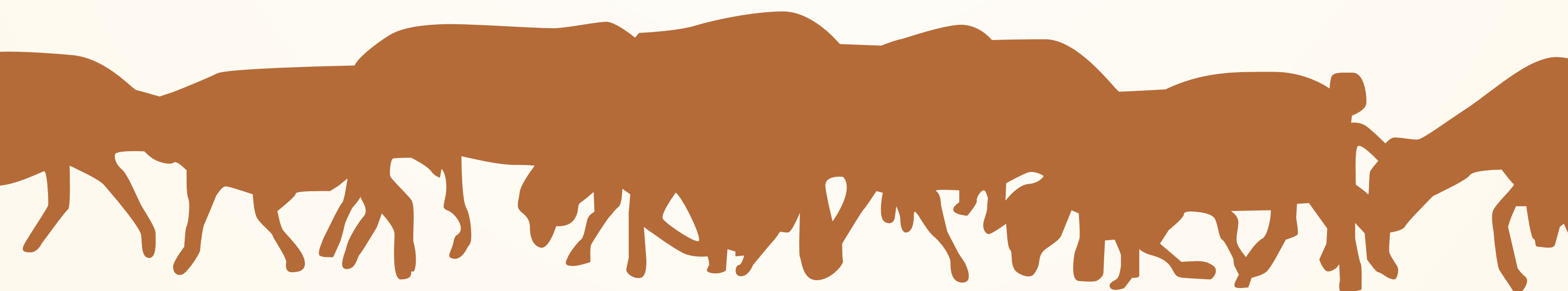
Fencing the Herd:

Protecting Your Company's Proprietary Interests with Restrictive Covenants

By Megan M. Belcher and Tracy M. Gullickson

As business environments evolve from the era of the industrial revolution and durable goods, to one of ecommerce and communication at light speed, the value of intellectual property has become more broadly recognized. More specifically, a company's intellectual property and confidential information has taken on increased importance in recent decades, particularly as we enter a new millennium, an age of defining what enables companies to lead the market and a challenging economic environment where every business advantage counts.

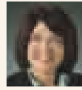


Consequently, as counsel for a company that seeks to protect its proprietary information and thus lead its competitors, you have an obligation to proactively consider how to protect that information. The largest opportunity for a third party to obtain an unfair advantage over one of its competitors is to exploit the competitor's proprietary information through the former employees who possess that confidential data. Therefore, in-house counsel should have a structure in place to:

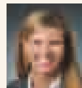
1. proactively protect the company's confidential information;
2. restrict former employees with confidential information from migrating to competitors, and the disclosure or use of the confidential information itself;
3. implement an internal system for protection of confidential information; and
4. quickly and effectively respond to threats to that confidential information.

If forced to protect its confidential information through litigation or otherwise, the company in question will need to demonstrate that it had structures in place to protect the confidential information if it expects to be successful in litigation. Companies can use one or several different types of restrictive covenants to accomplish that goal.[1]

Notably, the vast majority of all states recognize a common law doctrine — if not through a state trade secrets act — of protecting an organization's confidential and proprietary information from unfair intrusion. The governance of restrictive covenants is a creature of state law, which will typically need to be your primary area of focus. Similarly, there are federal statutory schemes that potentially protect employers in an array of situations. Thus, considering and identifying applicable state and federal laws and/or common law applicable to your company and particular arrangements will be the first step in creating any plan. For example, California, a state that strictly limits the enforcement of non-competition agreements through both statutory and common law structures, is illustrative of the type of state where special attention should be paid to the state regulation and the expertise of a local practitioner would be assistive.



MEGAN M. BELCHER is senior employment counsel in the law department of ConAgra Foods, Inc., where she focuses on the day-to-day management of the company's labor and employment matters. Prior to joining ConAgra, she practiced with Husch Blackwell Sanders LLP, defending corporate clients in their labor and employment litigation matters and providing counseling on human resources. She is a graduate of the University of Missouri and Boston College Law School. Belcher can be contacted at *megan.belcher@conagrafoods.com*.



TRACY M. GULLICKSON is an attorney with Husch Blackwell Sanders LLP in its labor and employment department. Her practice focuses on defending corporate clients in their employment matters and providing day-to-day human resource counseling. She is a graduate of Minnesota State University-Moorhead and Washburn University School of Law. Gullickson can be contacted at *tracy.gullickson@huschblackwell.com*.

1. Confidentiality and Intellectual Property Assignment Agreements

As a first line of defense in protecting your company's confidential information, you must first identify what information is confidential and/or proprietary, then the population of employees, independent contractors and/or vendors who have access to that information, and finally, what steps will be required to support the claim that the information deserves confidential treatment. Once that analysis is complete, you can begin work on creating a process or standards for protection of the confidential information, generating standard agreements for each population and a process for obtaining executed agreements from each.

Confidentiality agreements should contain a number of terms, which should both delineate what is confidential to the company, and clearly educate the executing party about their obligations and the consequences of failing to comply with them. At the outset, the company should identify its definition — pursuant to its initial analysis — of confidential information, which should include anything disclosed to or known by the party as a consequence of relationship with the company. Anything related to the company's trade secrets, customer lists and product, financial and other proprietary information that may or may not be patentable should be considered. The definition of confidential information should not include information generally known to the public or which, through no fault of company's own, becomes available to the public.

Once the drafter has defined what is to be protected by the agreement, the signing party's obligations can be set forth. First, the party should agree to protect and not disclose the confidential information of the company, and that the confidentiality agreement itself supplements any other agreements already executed. Second, the agreement should set forth the party's recognized access to confidential information. Third, the party should set forth its recognition that the success of the company depends on its confidential and proprietary information not generally being known to others and/or the public. The party should similarly recognize that the company possesses an important proprietary interest in maintaining the confidentiality of all its sensitive information.

Next, the drafter should include the very heart of the agreement: the signatory's assurance that he or she will not disclose or use the confidential information except as required in the course of employment with the company, or at any time during or subsequent to the signatory's relationship with the company. As a second level of protection, the signatory should also agree to immediately

report to management any security breach impacting the confidentiality of company information.

When considering the potential severing of the relationship between the parties, the agreement should contain a requirement that upon termination of the relationship, and/or at the request of the company, the signatory should deliver all materials that include confidential information.

To button down the ownership of the intellectual property developed by the employee or contractor on behalf of the company during the relationship, the drafter should also include an intellectual property assignment clause. In addition, if you deal with copyrightable material, utilize a "work-for-hire" clause which automatically vests the copyright for work created by an employee. The assignment clause is then a back-up to the works-for-hire provision.

The signatory should also agree to not only promptly disclose all inventions, discoveries, improvements, designs, trademarks or copyrightable matter conceived or made by the signatory during the period of relationship with company, but also agree to assign the same to the company. The agreement should further require that the signatory execute any applications, assignments or other instruments that the company deems necessary to obtain letters, patents, trademark or copyright registration or otherwise establish the company's rights in intellectual property.

If your company is working on a particularly sensitive project — for example, a fantastic new innovation or piece of big bet intellectual property development — then ensure you are creating a specific and higher-level confidentiality agreement. Maintain a list of project participants, ensure they are all executing the specific confidentiality agreement and work with your human resources department to set up a system by which you will receive notice of performance improvement plans (i.e., typically a precursor to termination), resignations and/or terminations for employees on the project team.

2. Non-Competition Agreements

While confidentiality agreements should be standard practice for most, if not all of your employees and third-party relationships, you should also consider whether non-competition agreements are warranted for a specific subset. Non-compete agreements are most typically seen in sales type positions and other job functions that have client and/or customer contact. In addition, employees with access to confidential information with respect to your company's trade secrets and/or other intellectual property should be similarly locked down with regard to their post-employment activities.

However, broad non-compete agreements used across a wide spectrum of your workforce will not be effective. Even more narrowly drawn restrictions on former employee mobility may be unenforceable in certain states (e.g., California). Unlike confidentiality agreements, non-competes restrict employees and third parties from engaging in a certain subset of work, which implicates their property interest in engaging in gainful employment or other business transitions. That heavier restriction ultimately leads to the courts having to engage in a balancing act of weighing the enforcing party's interest in protecting its proprietary information and the other party's ability to, quite frankly, earn a living.

A court **will look** more favorably on **non-compete agreements** that are focused, where the enforcing party can **articulate a compelling reason** to restrict, for example, its former **employee's employment**.

Therefore, companies considering using non-compete agreements should carefully select the population most appropriately restricted in their post-employment activities and then narrowly tailor and craft those agreements to target the company's needs. As illustrated by the balancing act discussed above, broad non-competes that unfairly restrict an employee's subsequent employment or a third party's business transactions will garner a court's disfavor. A court will look more favorably on non-compete agreements that are focused, where the enforcing party can articulate a compelling reason to restrict, for example, its former employee's employment. Again — and as fleshed out later in this article — your particular state(s) law will be the primary, if not overriding, focus of how far you may extend the reach of your non-compete.

3. Non-Solicitation Agreements

Your employees, customer contacts and customer relationships are equally, if not more, important than your intellectual property and confidential information itself. Consequently, it is prudent to protect your relationships with those individuals through a reasonable restrictive covenant prohibiting the solicitation of your employees, customers and clients. Like non-disclosure provisions, non-solicitation agreements are generally more favored and readily enforced by courts than true non-compete

agreements. Moreover, an organization that imposes carefully considered restrictions may have more luck with compliance and enforcement.

For example — and as with non-competes — narrowly tailored restrictive covenants are often looked upon more favorably by courts when compared to an overreaching non-competition agreement, especially in the current economic climate. Today's courts may determine it is just not equitable to restrict someone from working, regardless of the situation. However, by their terms, non-solicitation agreements do not prohibit a departing employee from working in his or her chosen field. In short, a well-drafted non-solicitation agreement can provide your organization with the protection it needs to safeguard its relationships with clients and employees.

A non-solicitation agreement may protect an organization in the same fashion that a non-competition agreement would under certain circumstances. As a result, an employee who is allowed to continue working in his or her chosen field may feel less restricted, more compelled to honor the agreement and less likely to consult an attorney who may ultimately challenge its enforceability. In turn, if a narrowly tailored covenant is challenged, a court may acknowledge that your organization selected the least restrictive means to protect its interests. Finally, an employee challenging a non-solicitation agreement will need to do much more to convince a court that he should be allowed to solicit his former employer's customers.

Indeed, while the current economic situation may favor employees in the non-competition context, it may favor employers in the non-solicitation context. For example, if a longstanding employee with substantial client relationships leaves your organization and convinces your clients as well as one or two similarly invested employees, to follow him to his new company, then there is an extremely compelling argument that this employee's actions are in fact jeopardizing the vitality of your organization, including everyone employed. Restraining one employee becomes an easier decision when compared with the potential job loss for many. It is easy to see that the loss of several major clients or customers can have a detrimental impact for any organization in any economic climate. Given the current outlook, organizations are justified in being overly protective of their client relationships.

As explained above, because of the significant financial harm the departure of even a small number of employees may inflict upon a business, protecting your organization from unfair solicitation requires an examination of whether there are employees who could cripple a business by calling on clients directly and/or hiring away key employees of the business in order to capture customers for its own benefit.

To avoid any potential "unclean hands" arguments, organizations should also examine how best to address situations involving new employees coming with existing non-solicit agreements from a former employer. If you are aware of a new employee's non-solicitation agreement, sit down with that employee and express the company's expectation that they comply with that agreement. Document that meeting and follow up with a written communication.

4. Primer on Implementing and Enforcing Restrictive Covenants

A. Practical considerations regarding enforcement

On the front end, you should consider and form a plan regarding employees with restrictive covenants who are leaving your organization. By deciding your approach up front, you will be consistent. If a situation later develops and proceeds to court, then your organization may benefit by showing that it deals with all departing employees in a consistent manner, thereby avoiding a potential "selective enforcement" argument.

As mentioned previously, the first consideration should be to draft tailored and specific agreements that provide full protection to your organization, while not overly restricting a departing employee. Remember, a court will not restrain an employee from engaging in ordinary competition. Devoting time and resources to this task up front will provide you with credibility, should enforcement become an issue. In addition, because of the expense involved in litigating the enforceability of restrictive covenants, there is certainly a financial incentive to avoid legal disputes.

Counsel should similarly analyze, in advance of requesting an employee's execution of a restrictive covenant, whether there is adequate consideration to support it. Restrictive covenants are, at their essence, contracts. Consequently, they must be supported by adequate consideration. Many states consider employment or continued employment enough to support the covenant. However, some states do not and require something greater, namely monetary or other additional consideration in "trade" for the employee's promises. Ensure you are reviewing and considering your state's governance on that issue so that you are not later arguing over a potential foundational contract defect.

After an employee gives notice that he or she is leaving your organization, inquire about his or her future plans. At this point, remind the employee of their agreement, including confidentiality provisions, and provide him or her with a signed copy of any agreements in effect. Make note of your conversation and the information the employee provided to you regarding future employment, as well as any unusual response to discussions regarding

the agreement. Depending on the information you receive and the employee's position, you may consider reviewing their computer activity, paying attention to the contents of emails sent to the employee's home email address or emails with clients regarding the employee's departure from the company. Similarly reviewing an employee's download history and/or access to a jump or flash drive is also assistive.

If you learn that a former employee may be in violation of his or her agreement with your organization, try to do as much investigation as you can about the suspected violation to determine whether you can resolve the issue without costly legal fees. This initial investigation will assist your organization in analyzing the situation and help determine the best course of action. To that end, it is a good idea to include a provision within your agreements requiring the employee to respond to written inquiries within a specified time period.

Send a letter to the former employee reminding him or her of the major provisions within the agreement and their ongoing obligations. The letter should also request

ACC Extras on…Protecting Intellectual Property

ACC Docket

- *Taking on IP (Dec. 2008).* This article outlines how to best handle IP assets. *www.acc.com/docket/ip_dec08*
- *New to In-house: Data Security in a Digital World (Oct. 2007).* It's important for lawyers who are new to in-house to recognize that corporate executives may assume that you are an authority on data security and privacy, even if you are not. This article gives you the basics. *www.acc.com/docket/datasecure_oct07*
- *Why General Counsel Should Pay More Attention to Intellectual Property (May 2007).* If GCs fail to pay enough attention to intellectual property in today's economic environment, careers can be in jeopardy and shareholder value can be lowered. This article explores why paying more attention to your company's IP is so important. *www.acc.com/docket/ip_may07*
- *Negotiating the Thicket of IP Clauses: Nine Key Issues for Negotiating Intellectual Property Clauses in Consultancy Contracts (May 2005).* When companies negotiate contracts with IT consultants for information technology, one of the most hotly contested issues is intellectual property rights. There are many potential IP issues — this article addresses your options. *www.acc.com/docket/ipnegotiations_may05*
- *Three Crucial Questions – and Answers – for Protecting IP in a Deal: What Every In-house Counsel Should Know (March 2005).* This article will tell you how to assess the IP aspects of a proposed transaction, conduct and complete due diligence to the extent it affects intellectual property and draft the provisions of the purchase agreement relating to the transfer of intellectual property rights. *www.acc.com/docket/protectip_mar05*

InfoPAK℠

- *Intellectual Property Primer: Patents, Trademarks, Copyrights and Trade Secrets – An Introduction to Intellectual Property for In-house Counsel 3rd Edition (July 2008).* This InfoPAK provides corporate counsel with a general overview of intellectual property and suggests useful practices for its handling in the corporate setting. *www.acc.com/infopaks/ipprimer_jul08*

Program Materials

- *Keeping the Company's Secrets: Protecting Proprietary Information (Jan. 2005).* This panel of IP and employment law experts coaches you through the methods to put a protective wall around your company's prized assets. Includes detailed checklists and procedures to design and implement an enforceable IP protection program. *www.acc.com/protect_propinfo_jan05*
- *Trade Secrets and Restrictive Covenants – Competing Considerations in a Mobile Marketplace (Oct. 2004).* From the 2004 Annual Meeting 601. *www.acc.com/tradesec_restrcov_oct04*

Article

- *Top 10 Intellectual Property Tips and Pitfalls (May 2006).* This article reviews the problems that may arise with intellectual property. Includes tips such as paying attention to state law IP rights and understanding open source licensing models in order to avoid IP problems. *www.acc.com/ip/tips&pits_may06*

Sample Form & Policy

- *Non-Disclosure and Restrictive Covenant Agreement (Nov. 2005).* A sample confidentiality agreement with restrictive covenants that is not intended to represent or imply any employment contract or other contractual obligation with regard to duration of employment. *www.acc.com/restric_covagree_nov05*

ACC has more material on this subject on our website. Visit *www.acc.com,* where you can browse our resources by practice area or use our search to find documents by keyword.

> Of course, choice of **law provisions** are the most **useful tool** to **control** your jurisdiction, but **are not** a complete **jurisdiction guarantee.**

that the employee respond to any specific questions, and/or affirm that he or she is or has not been not violating the agreement. The letter may also assist you in determining whether the employee has sought counsel, as any response may come from an attorney or be written in a tone that suggests counsel is involved. Of course, the employee may not respond to your letter, but failure to respond may be used if your organization determines that legal intervention is necessary. A judge will be more inclined to grant injunctive relief if you can demonstrate that you provided the employee an opportunity to respond to the concerns before seeking assistance from the court.

If your organization determines that legal action is necessary then you have the option of bringing a lawsuit requesting injunctive relief, including a temporary restraining order. Depending on the situation and your jurisdiction, other potential claims may include misappropriation of trade secrets, violation of computer crime statutes, fraudulent misrepresentation, breach of duty of loyalty, tortuous interference with contract and/or breach of contract.

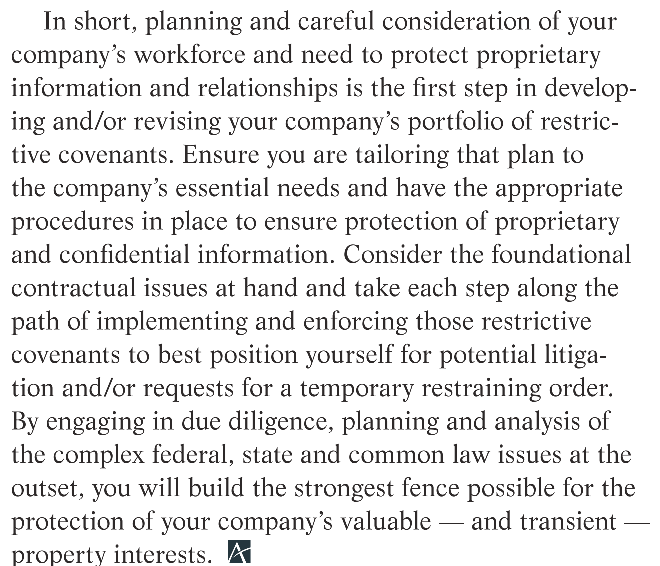
B. General enforcement provisions

To be enforceable, restrictive covenants must generally be reasonable under the circumstances and not adverse to public welfare. There is a great deal of room for interpretation here, but this typically means that the covenant must not prohibit ordinary competition, but rather protect the legitimate business interests of the employer. In addition, the time and territorial limitations contained in the covenant must be reasonable based on your jurisdiction and the circumstances of each case. By reviewing decisions in your jurisdiction, you can determine what time and territorial limitations are deemed reasonable by the courts. Typically, a larger territorial limitation coupled with a smaller time limitation is more likely to be considered reasonable and vice versa. Generally speaking, most restrictive covenants deemed reasonable are limited to a one or two-year time period. However, the important point is that you are able to articulate to the court why the time and territorial limitations are necessary and why they are justifiable based on the circumstances.

Some states have statutes whereas other states rely on common law decisions. Some states carry additional requirements creating unique issues. There are also statutes that govern the enforceability of restrictive covenants regarding specific professions. Consequently, it is imperative to consider the laws of the state in which the employee resides, as well as any other states that an action may potentially be filed. Of course, choice of law provisions are the most useful tool to control your jurisdiction, but are not a complete jurisdiction guarantee.

If the restrictive covenant is deemed overbroad, most courts will "blue pencil" the covenant, which narrows the scope to make the covenant enforceable. The court however, has discretion regarding its use of equitable powers to modify the covenant. For example, a court has no authority to modify a restrictive covenant to create a contract where the parties did not mutually assent to modification or where there was no meeting of the minds. In other words, the court will not typically insert provisions that were not contemplated in some fashion within the agreement. Additionally, your agreement must include language demonstrating the parties' request to have the court modify a restrictive covenant that is found to be overbroad.

Craft and Tailor Your Restrictive Covenant Plan — and Stick to It



In short, planning and careful consideration of your company's workforce and need to protect proprietary information and relationships is the first step in developing and/or revising your company's portfolio of restrictive covenants. Ensure you are tailoring that plan to the company's essential needs and have the appropriate procedures in place to ensure protection of proprietary and confidential information. Consider the foundational contractual issues at hand and take each step along the path of implementing and enforcing those restrictive covenants to best position yourself for potential litigation and/or requests for a temporary restraining order. By engaging in due diligence, planning and analysis of the complex federal, state and common law issues at the outset, you will build the strongest fence possible for the protection of your company's valuable — and transient — property interests.

Have a comment on this article? Email editorinchief@acc.com.

NOTE

1 The protection of copyrights and the automatic transfer of ownership to the employer under the "work-for-hire" doctrine is beyond the scope of this article.