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Protecting Your Business Interests with Restrictive Covenants

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EXPAND YOUR EXPECTATIONS™

Let's Start with the Basics ...

Restrictive covenants come in three forms:

- Non-Compete Agreements
- Non-Solicitation Agreements (Customers & Employees)
- Non-Disclosure or Confidentiality Agreements

Initial Considerations

- What are you trying to protect?
 - Customer relationships
 - Good will
 - Trade secrets/confidential information
 - Investment in your employees
- Use these factors to decide which of your employees you will ask to sign restrictive covenants

Initial Considerations (con't)

- Is the restrictive covenant enforceable in the state or states in which you are likely to file suit to enforce it?
- Is the restrictive covenant supported by sufficient consideration?
- Is the scope of the restrictive covenant (both geographic and temporal) broad enough to protect your business, but reasonable enough to be enforced?

Recognized Protectable Interests

- *Specialized Training*
 - General skill, knowledge and general job training is *not* protectable
 - Important considerations are the amount of time involved in the training and the company's monetary investment in the training



Recognized Protectable Interests

- Trade Secrets and/or Confidential Information
 - Customer information readily ascertainable from public sources is *not* entitled to protection
 - For example, information that can be gleaned from the yellow pages, Google searches or publicly available lists
 - Access to all of an employer's clients + knowledge of pricing schedules and terms of contracts = protectable interest

Recognized Protectable Interests

- Important Point:
 - Calling information “confidential” or a “trade secret” in the language of a restrictive covenant is helpful but generally does not make it so

Recognized Protectable Interests

- Customer Relationships/"Face of the Company"
 - Typically arises in the context of sales people or executive-level employees
 - Personal contact may not be enough, especially when product quality drives the customer's decision
 - Close contact over a long period of time, money spent developing the relationship, and other, similar factors weigh in favor of the relationship being protectable
 - If you can prove the former employee's contacts that were developed during his employment with you would give him an unfair advantage, then such contacts could be protectable

Elements of Enforceable Non-competition Agreement

Section 15.50 establishes five distinct elements that must be present in order for a noncompetition agreement to be enforceable. The agreement must:

- Be ancillary to an otherwise enforceable agreement at the time it is made;
- Protect a legitimate business interest;
- Contain reasonable limits on scope of activity to be restrained;
- Contain reasonable geographic limitations; and
- Contain reasonable durational limitations

Time and Territory Limits

- Time & territory limits generally cannot be more restrictive than necessary to enforce legitimate protectable interests
- Former employees generally cannot be excluded from working in regions in which they did not work for you
- As technology evolves, however, geographic limitations are becoming less common
- Geography generally isn't considered when the restrictive covenant at issue is a non-solicitation agreement
- Time limitations are usually fact-specific and based on market forces



Adequate Consideration

- Texas has adopted a “designed-to-enforce-a-contractual obligation” standard.
Two prong test --
- The consideration given by the employer must give rise to the employer’s interest in restraining the employee from competing; and
- The restrictive covenant must be designed to enforce the employee’s consideration or return promise.



Enforcement and Remedies

All non-competition agreements constitute a restraint of commerce and will be carefully scrutinized by the courts.



- Injunctive Relief
- Damages

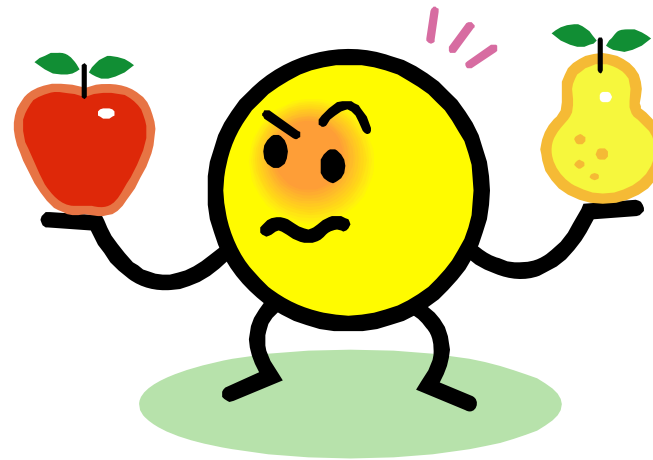
Reformation – Blue lining Provision

Section 15.51(c) mandates that court reform to the extent necessary if overly broad as to time, geographic area, or scope of activity restricted

- No damages for employer for breach that occurs before reformation
- Employer may be at risk for employee's attorney's fees

Deciding Whether to File Suit

- Each case will stand or fall on its own facts
- Restrictive covenant cases are decided on a case-by-case basis
- Judges vary widely in their view of restrictive covenants



Deciding Whether to File Suit

- Carefully weigh your suspicions about what your former employee is doing against what you can actually prove
- Discovery, however, can be used to remove these uncertainties about your former employee's conduct



Deciding Whether to File Suit



- Does the cost and disruption of litigation outweigh the damage inflicted by the former employee?
- Filing suit may deter the former employee's future misconduct
- Filing suit may “send a message” to your other employees with restrictive covenants

NONDISCLOSURE AND CONFIDENTIALITY AGREEMENTS

Strategies for Protecting Trade Secrets and Confidential Information

Identify Your Trade Secrets

- ✓ Technical Information
- ✓ Production and Processing Information
- ✓ Vendor and Supplier Information
- ✓ Quality Control Information
- ✓ Sales and Marketing Information
- ✓ Financial Information
- ✓ Internal Administrative Information

Managing Tangible Trade Secrets

- Identify an appropriate storage system, including appropriate storage media, systems and devices
- Identify appropriate storage locations
- Document all of this



Restricting Access

- Establish company policies and regularly review/update them
- Establish specific security procedures and regularly review/update them
- Regularly conduct audits of these policies and procedures



Restricting Access (con't)

- Develop procedures for correcting inadvertent disclosures
- Establish a policy of pursuing theft of trade secrets and other confidential information
- Develop a document retention/destruction policy



Restricting Access (con't)

- Assign a specific employee the responsibility for managing your trade secrets (*i.e.*, a “trade secret czar?”)
- Consider whether a multi-disciplinary committee is appropriate to assist your “trade secret czar”
 - Include employees from IT, Operations, R&D, HR, Legal ...

“Walk the Talk”

- Written agreements, policies and procedures are very helpful ...
- But, *actions* are often more important than words
- Consider the following strategies to increase your chances of protecting your company’s trade secrets

Non-Disclosure Strategies

- Identify employees who have a “need to know”
- Regularly train these “need to know” employees
- Develop strict policies and procedures for *remote access* by these employees



Promote a Culture of Confidentiality

- Regularly discuss confidentiality obligations in employee meetings?
- Review confidentiality obligations during employee performance reviews?
- Avoid disclosing confidential information through electronic communications, website postings, marketing materials, etc.
- Take advantage of “teaching moments” when mistakes are made

Damage Control Strategies When Employees Resign

- An employee tenders her resignation. You're concerned about protecting your company's trade secrets
- What do you do?



First Steps

- Identify whether the departing employee had access to trade secrets
- Inventory all sensitive documents and things to which the employee had access



Next Steps

- Inventory all electronic data to which the employee had access, including software source code
 - Note “last edit” dates and “edited by” information
- Access the employee’s e-mail account and look for suspicious activity
- If you suspect theft of data, immediately order a forensic imaging of the employee’s hard drive

Conduct an Exit Interview

- Include an HR representative and the employee's manager
- Present the employee copies of her non-competes, restrictive covenants, policy acknowledgments and/or applicable policies
- Ask the employee to confirm that she intends to honor her agreements and the company's policies
- Communicate the company's expectations
- Ask about the employee's plans for future employment and press for details



The Cease and Desist Letter

- Consider sending a “cease and desist” letter to the former employee *and* her new employer (if applicable)
- Include copies of the resigning employee’s non-compete, restrictive covenants, policy acknowledgements and applicable policies
- Make your intentions clear
- Threaten litigation and prepare to follow through



Litigation Cons

- It will be expensive
- It can take longer than you had hoped
- It can be time consuming and disruptive for your employees
- The results can be hard to predict and you may walk away disappointed



Litigation Pros

- It “sends a message” to your competitors
- It “sends a message” to your employees
- The value of putting an end to unfair competition or the theft of your trade secrets may be worth the costs
- It may be the only sure way to stop unfair competition or theft of your trade secrets



PREVENTATIVE MEASURES

Hiring Strategies to Reduce Your Risk of Being Sued by a Competitor

Pre-Offer Steps

- Instruct the candidate in writing to remain loyal to their current employer as long as they are still employed by them
- Instruct the candidate in writing that he shall not share his current or former employer's business data with your company
- Request a written acknowledgement that the candidate is not bound by any non-compete, non-solicitation or similar agreement

Offer or Post-Offer Steps

- Clarify in writing that the employment offer is contingent on the new employee's pre-employment disclaimer of any non-compete or non-solicitation agreements with their former employer or their promise to honor the restrictive covenants with their former employer
- Develop a strategy for monitoring the new employee's compliance with these commitments

QUESTIONS?

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