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Bulletin #71, Non–compete, Non–solicitation and Confidentiality Agreements (September 19, 2003)

In business, our most important assets are often our employees and the information we develop through years of hard work. Retaining key employees and important business information can mean the difference between success and failure. There are three key agreements to help you keep employees and protect information:

- Non–compete/Non–competition Agreements;
- Non–solicitation Agreements; and
- Confidentiality/Non–disclosure Agreements.

All of these agreements are "restraints on trade" and are disfavored in the American courts. Our capitalist system encourages competition and any "restraints on trade," preventing people from switching jobs or exchanging information, will be limited by the courts. Therefore, if you want to enforce these types of agreements, you must have your "ducks in a row." Put another way, if an employee or a court can find a way to prevent you from enforcing these agreements, it will. Making sure these agreements are properly drafted and signed can provide you with a powerful tool in running your business.

(This article contains a general discussion of the law. You should consult with your attorney on the law in your state, as well as make sure you have a properly drafted agreement, including other provisions, which are not discussed in this Contracts Bulletin, *e.g., enforcement, venue selection, and other important clauses.)*

Non–compete/Non–competition Agreements

Defined

These are provisions or agreements variously described as "non–competes," "non–competition agreements," or "restrictive [employment] covenants." These agreements are used by employers to prevent an employee from competing with the employer (or taking the employer's customers) during or following employment.

Example Clause

An example of a non−compete provision is as follows:

> Employee agrees that during the term of Employee's service with Employer, and for a period of twelve (12) months following the termination of service with Employer, Employee shall not directly or indirectly, acting individually or on behalf of another person or entity, enter into employment or render any services in the State of _____ that provides, sells, repairs or maintains HVAC, or other general repair or maintenance of commercial or residential buildings.

(This is merely an example provision, which should be discussed with your lawyer as part of any agreement.)

Limits

Because non−competition agreements prevent people from being employed, courts look for ways to prevent employers from enforcing the agreements. If the agreement is "overly broad," it will be treated as void or will be re−written by courts to have more "reasonable" terms.

The courts require that non−competition agreements be "reasonable" in three ways:

- Geographic Scope – A non−compete agreement usually has some geographical limit where the new employee cannot compete with the employer. For example, an agreement may contain a provision that prevents a former employee from working anywhere in the Twin Cities. This provision would likely be found to be reasonable (if the other requirements as to "time" and "industry description" discussed below are also satisfied). Conversely, preventing a former employee from working anywhere in the United States would likely be found to be unreasonable.

- Time – The agreement must be reasonably limited as to time. That is, an employee cannot be barred from competing for too long following termination of employment. In mature industries (e.g., auto manufacturing or home construction), non−competes of up to three years may be enforceable. In rapidly developing industries (e.g., Internet sales or wireless communications), shorter periods of usually under a year will be enforced.

- Industry Description – The non−compete must be reasonably limited as to the description of the industry subject to exclusion. For example, preventing an employee from work in the entire construction industry may be excessive, but excluding HVAC installation and repair may be appropriate.

The significance of these limitations is that even though you might be able to convince an employee to give you a ten−year non−compete, which prevents the employee from performing any work in the construction industry anywhere in the United States, a court will NOT enforce such a provision because it is not "reasonable." Again, our capitalist system wants employees to be able to get new jobs when they leave employment. As an employer, you can only impose "reasonable" limitations on the employee's ability to find new work.

Consideration to Employee

A term which is often used when discussing non−competes is "consideration." "Consideration" means that the employee must be given a payment or some other reward for agreeing to sign a non−compete

provision.

If an agreement is signed at the time an employee is hired, there is no issue with respect to the consideration. The consideration for the non−compete agreement is the hiring of the employee.

It is important to note that in many states having an employee sign a non−compete, even one week after hiring, may make the agreement unenforceable. The typical example where courts have refused to enforce non−compete agreements is when the employee has started work and a supervisor says: "Oh, yeah, we want you to sign this non−compete as part of your job. Everyone signs one." Even if the employee "voluntarily" signs at that time, courts may be very unwilling to enforce the agreement because this was a term imposed after employment began.

If an employer wants to have an employee sign a non−compete agreement following hiring, most states require "real and substantial consideration." This generally does **not** mean paying an employee $200 to sign a non−compete if he/she is making $50,000 a year. It usually means a significant percentage of his/her current salary is paid as the consideration to support the agreement.

It may be possible to have an employee sign an enforceable non−compete as part of his/her annual review. The employer can state that some of the employee's [pay] raise is the consideration to support a non−compete. However, this is a "touchy" issue, which requires you to consult with your attorney. The law is changing rapidly and varies in virtually every state.

Non−solicitation Agreements

Defined

Non−solicitation provisions or agreements prevent employees from soliciting the former employer's current employees. Put another way, this prevents a former employee from "cherry picking" away your best employees.

Once again, this is a "restraint on trade" and is disfavored by the law. However, courts have been more willing to enforce provisions, which prevent a former employee from injuring his/her former employer, by inducing the employer's current employees to leave for a competitor.

Example Provision

Below is an example of a non−solicitation provision:

> Employee agrees that during the term of Employee's service with Employer, and for a period of twelve (12) months following the termination of service with Employer, Employee shall not approach, entice, or solicit any employees of Employer to leave the employ of Employer and either join Employee in consulting or employment with any other person, firm, company or other entity which is providing, selling, repairing or maintaining HVAC, or other general repair or maintenance of commercial or residential buildings.

(This is merely an example provision, which should be discussed with your lawyer as part of any agreement.)

Consideration to Employee

If the non−solicitation provision is signed at the time the employee is hired, "consideration" is not an issue. There are fewer court decisions deciding whether an employer must provide consideration to have a valid non−solicitation provision signed by an employee **after** the employee is hired. However, given the

general trend in the law, it is likely that courts would require "real and substantial" consideration to enforce non−solicitation clauses if the employee signs the agreement after the employee is hired. Once again, if you want an employee to sign a non−solicitation agreement after he/she is hired, you should consult your attorney.

Confidentiality/Non−Disclosure Agreements

Defined

These provisions or agreements prevent employees from disclosing "confidential information," which the employee learned while working for the employer. Sometimes these agreements are also called "non−disclosure" agreements, but the effect is the same; an employee is prevented from giving confidential information he/she has learned while an employee to anyone outside the employer's business. Confidential information may not be disclosed even after the employee is no longer working for the employer.

Example Clause

> The Employee is hereby barred from disclosing Confidential Information during and following the Employee's employment with the Employer to anyone without the express written consent of the Employer. "Confidential Information" shall mean all information not generally known, including trade secrets (whether oral, written, or in other tangible form), which relates to the manufacture, use, sale or marketing of Employer's products or components of such products, including, but not limited to: knowledge or information developed by you while an employee, including any sales materials, pricing, products, techniques, software, customer lists, or management or technical information and the like.

(This is merely an example provision, which should be discussed with your lawyer as part of any agreement.)

Limits

As with all "restraints of trade," courts will not protect information which is not truly "confidential." Merely indicating in an agreement that information is "confidential" does not automatically mean that it is truly "confidential."

For example, typically, "customer lists" are identified as confidential information. However, if the employer lists its customers on its Web site, then later tries to claim the former employee violated the confidentiality agreement by disclosing the customer list, the court will not find the employee breached because the information was not actually "confidential." However, in the absence of public disclosure, courts recognize the importance of developing confidential information, and will generally protect the employer from the disclosure of confidential material.

Consideration

Whether consideration is required to enforce a confidentiality agreement varies from state to state. If an employee signs a confidentiality agreement at the time the employee is hired, all states would enforce such an agreement if it was reasonable. However, some states require consideration if an employer asks an employee to sign a confidentiality agreement following the employee's hiring. If you want a current employee to sign a confidentiality agreement, you should contact your own attorney to determine whether consideration is required.

Extra Credit – Trade Secrets

Question: Is “confidential information” the same as “trade secrets?”

Answer: No.

Confidential information, as I discussed above, is merely information that is not available to the public. For information to be a “trade secret,” specific requirements must be met. There are two major requirements in order to assert that information is “trade secret:”

- Availability – The information must not be “readily ascertainable by proper means;” and
- Efforts to Protect – There have been “efforts that are reasonable under the circumstances to maintain its secrecy.”

What does this mean? First, the information must be truly “confidential” (as discussed above). Second, you must protect it (this is the additional requirement to have a trade secret).

If you want something to be a trade secret, it must be “secret” (a.k.a. confidential) and you must also take steps to treat it confidential (e.g., stamp documents “confidential” and, depending on the nature of the information, engage in other security measures). For example, at the headquarters of many companies, visitors must be met at the door, sign a log book, and have an identification pass as they move through the buildings. Another precautionary measure is to carefully stamp all secret information ‘confidential’ and keep the documents in a safe place. This is not only to prevent someone from stealing the information, but it also allows the company’s lawyers to argue that the products it has developed at great expense are “trade secrets.” If an individual violates the trade secret law, there are substantial damages, including attorney’s fees, that can be recovered.

Conclusion

In an increasingly competitive marketplace, retaining key employees and preventing former employees from giving away confidential information or soliciting other current employees can mean the difference between success and failure. While non–compete, non–solicitation and confidentiality agreements are restraints on trade which are disfavored under American law, if carefully drafted by your lawyer and properly signed with consideration, they can be powerful tools. You invest great effort in securing customers and training employees; these agreements can help you protect those investments and grow your business.

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