

Noncompete Agreements and Unfair Competition

By William M. Corrigan, Jr. and Michael B. Kass

It is a common scenario. Your company loses a key executive or valuable salesperson to the competition. The company is obviously concerned about losing customers or having its confidential business information used by a competitor to obtain an unfair competitive advantage. The CEO tells you, “this employee can really hurt us if he is permitted to work for our

competitor” or “we have to send a message to our employees that we enforce our noncompetes,” and he commands, “go enforce the noncompete!” After all, says the CEO, “a contract is a contract.”

If it were only that easy. You gently tell the CEO, “not when it comes to noncompete agreements.”

Indeed, a nuance not always appreciated by the client is that, although the employee may have signed a noncompete, that fact does not always, in and of itself, prevent employment with the competitor. Despite the widespread use of restrictive covenants, and noncompete agreements in particular, employers and their employees often have misconceptions about the enforceability of the agreements. The employer is often convinced of its ability to enforce a noncompete agreement to prevent its employee from competing, while the employee often

believes that the restrictions are so stifling that they would never be enforced against him. In other words, one of the parties to a noncompete or other restrictive covenant often has a misconception.

Employees, and companies hiring employees from their competitors, must be aware that most jurisdictions do provide for at least limited enforcement of noncompete agreements. However, employers must also be aware that a court typically will not enforce such agreements merely to protect the former employer from competition. Noncompetes are generally enforced to prevent unfair competition. They are typically enforceable to the extent that they are reasonably necessary to protect recognized interests of the employer.

The key to protecting a company from unfair competition is the implementation of policies and practices that will give the

company the best chance at enforcing its noncompete agreements and obtaining trade secret status for its valuable confidential business information. For the employers, the key to avoiding claims of unfair competition when hiring also requires the implementation of appropriate practices. With respect to both of these perspectives, this article provides a general overview of how noncompetes operate in most jurisdictions that allow for the use of the agreements, as well as briefly summarizes various types of state statutes and laws that give additional remedies to companies faced with employees taking data or joining the competition. Finally, this article suggests some basic, practical steps to maximize a company’s ability to both pursue and defend against claims for enforcement of noncompete agreements.

Enforceability of Noncompetes

Contracts are enforceable, right? Not always, at least not when it comes to noncompete agreements. Indeed, in most jurisdictions allowing for the use of noncompete agreements, we are told, in effect, that their purpose “is to protect an employer from unfair competition by a former employee without imposing unreasonable restraint on the latter.” *Superior Gearbox Co. v.*



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Edwards, 869 S.W.2d 239, 247 (Mo. App. S.D. 1993) (quoting *Continental Research Corp. v. Scholz*, 595 S.W.2d 396, 400 (Mo. App. E.D. 1980)). See also *Premier Assocs., Ltd. v. Loper*, 778 N.E.2d 630, 639 (Ohio Ct. App. 2002); *Prudential Secs., Inc. v. Plunkett*, 8 F. Supp. 2d 514, 519 (E.D.Va. 1998) (applying New York law). Employers generally cannot extract restrictive covenants from employees merely to protect themselves from competition.

In jurisdictions enforcing noncompetes, one of the primary issues examined by the courts is whether the employer has some legitimate interest that would be served by enforcing the agreement. The two most common interests an employer may protect are the employer's trade secrets and customer relationships (also sometimes referred to as "goodwill"). See, e.g., *Healthcare Services of the Ozarks v. Copeland*, 198 S.W.3d 604, 610 (Mo. 2006) (non-compete agreements are enforceable "only to the extent that the restrictions protect the employer's trade secrets or customer contacts"); *Victoria's Secret Stores v. May Department Stores Company*, 157 S.W.3d 256, 260 (Mo.App. E.D. 2004) ("[a] restrictive covenant... is only valid and enforceable if it is necessary to protect trade secrets and customer contacts..."); *Johnson Controls, Inc. v. A.P.T. Critical Sys., Inc.*, 323 F. Supp. 2d 525, 532 (S.D.N.Y. 2004) (the "significant goodwill built up during [the former employees'] long-term service of [the] clients" of their former employer gives rise to enforcement of their noncompete agreements); *Brentlinger Enters. V. Curran*, 752 N.E.2d 994, 1001 (Ohio App. 2001) (confidential information and trade secrets are legitimate interests giving rise to enforcement); *National Interstate Ins. Co. v. Perro*, 934 F. Supp. 883, 890 (N.D. Ohio 1996) (employer had a legitimate interest in protecting its confidential information and "preventing employees from exploiting the customer relationships developed at its expense and in its name"); Fla. Stat. Ann. §542.335 (West 2005) (stating that trade secrets, valuable confidential business information, substantial customer relationships and customer goodwill constitute "legitimate business interests" giving rise to enforcement of a noncompete). These two interests often represent the heart of the litigation over a noncompete

agreement, as an employer must show that at least one of those interests will be protected by enforcement of the noncompete agreement. Other issues examined by the courts include whether the agreement is reasonable and sufficiently limited in terms of its geographic and temporal scope.

What Is a Trade Secret (or Confidential Information) and How Can an Employer Protect It?

Before defining the types of information that may qualify as "confidential information," or "trade secrets" giving rise to enforcement of a noncompete, it bears noting that one of the most important characteristics of the information making it protectable is that it *actually be confidential* or, at the very least, the employer must have taken reasonable steps under the circumstances to maintain its confidentiality. *Kessler-Heasley Artificial Limb Co., Inc. v. Kenney*, 90 S.W.3d 181, 188–89 (Mo. App. S.D. 2002) (quoting *AEE-EMF, Inc. v. Passmore*, 906 S.W.2d 714, 722 (Mo. App. W.D. 1995)).

Most states have either adopted some form of the Uniform Trade Secrets Act ("UTSA") or follow the Restatement of Torts in defining what qualifies as a "trade secret" under state law. See, e.g., *Ashland Mgmt. v. Janien*, 82 N.Y.2d 395, 407, 624 N.E.2d 1007, 1013 (quoting Restatement of Torts §757); Mo. Ann. Stat. §417.450 *et seq.* (West 2004); Ohio Rev. Code Ann. §1333.61 *et seq.* Pursuant to both the UTSA and many common law definitions, trade secrets consist of "technical or non-technical data, a formula, pattern, compilation, program, device, method, technique, or process that derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by other persons who can obtain economic value from its disclosure or use." *Conseco Finance Serv. Corp. v. North American Mortgage Co.*, 381 F.3d 811, 818–19 (8th Cir. 2004). A "trade secret must be secret" or must have been "the subject of efforts that are reasonable under the circumstances to maintain its secrecy." *Kessler-Heasley*, 90 S.W.3d at 188–89, *Conseco Finance Serv.*, 381 F.3d at 819. See also Mo. Ann. Stat. §417.453(4)(b); Ohio Rev. Code Ann. §1333.61 *et seq.* "Matters of public knowledge or of general knowledge in an indus-

try are not trade secrets." *Kessler-Heasley*, 90 S.W.3d at 188.

In certain circumstances and depending on the jurisdiction, a trade secret may include customer information and customer lists, codes for determining discounts, price structures, price lists and profit margins. *Conseco Finance Serv.*, 381 F.3d at 819; *Kessler-Heasley*, 90 S.W.3d at 188 ("a trade secret may also include a list of customers"). Cf. *Briskin v. All Seasons Servs., Inc.*, 615 N.Y.S.2d 166, 167 (App. Div. 4th Dep't 1994); *Data Sys. Computer Centre v. Tempesta*, 171 A.2d 724, 725 (App. Div. N.Y. 2nd Dep't 1991).

More on the Uniform Trade Secrets Act

The UTSA provides remedies for misappropriation, and threatened misappropriation, of a company's trade secrets by a former employee (or any third party) with or without a noncompete agreement. As with non-compete agreements, in order to prevent a former employee from competing under the UTSA, the former employer "must do more than assert that a skilled employee is taking his abilities to a competitor." *Carbonline Co. v. Lebeck*, 990 F. Supp. 762, 767 (E.D.Mo. 1997) (citing *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1269 (7th Cir. 1995)).

Some jurisdictions have adopted what is commonly known as the "inevitable disclosure" doctrine. In general, the inevitable disclosure doctrine provides—as one would expect from its name—that an employer may enjoin an employee from working for a competitor if it is "inevitable" that the employee will use or disclose his or her former employer's trade secrets. See, e.g., *Strata Marketing, Inc. v. Murphy*, 740 N.E.2d 1166, 1177–79 (Ill. App. Ct. 2001) (citing *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262 (7th Cir. 1995)). However, particularly in states where the inevitable disclosure doctrine has not been adopted, if an employer wants the most protection against the disclosure of its trade secrets, it should have its employees sign noncompete and confidentiality agreements rather than rely on statutory protections.

Again, even though information may at first blush seem to be a trade secret because it is of such high value to the employer, if it is not *actually* confidential or if *reasonable efforts* have not been employed to maintain its confidentiality, it may not qualify

as a protectable interest either for the purposes of enforcing a noncompete agreement or enforcing rights under the UTSA. Whether the former employer's purported confidential information or trade secrets (e.g., price structures, profit margins, and certain types of customer lists) are, in fact, secret or whether they are generally known within the industry must be analyzed on a case by case basis. It stands to follow, therefore, that a company must have in place appropriate confidentiality policies and procedures if it wants to enforce noncompete agreements or obtain statutory protection for valuable business information (see checklist below).

Once a Trade Secret, Not Necessarily Always a Trade Secret: Why One National Retailer Was Unable to Enforce Its Noncompete

When that CEO comes to you and says "enforce this noncompete," never assume that because the departing employee may have been a senior executive that the agreement will be enforced. Each situation must be analyzed on its merits, as illustrated in a high profile case involving Victoria's Secret Stores and May Department Stores Company.

In *Victoria's Secret Stores v. May Department Stores Company*, 157 S.W.3d 256, 263 (Mo. Ct. App. 2004), a former May Company executive sought to accept an executive position with Victoria's Secret. In affirming the trial court's refusal to enforce the noncompete agreement, the Missouri Court of Appeals held, in part, that May could not show that it had "trade secrets" that would be protected by enforcement of the noncompete because the trade secrets at issue had a short shelf life. The court found that the strategic plans produced by May's intimate apparel business were changed and updated every couple of months. Moreover, other reports purportedly critical to May's intimate apparel business were useful for no more than a six-month time period. The Court of Appeals noted that, "while the actual reports themselves would be potentially valuable to a competitor when issued, the useful life of the reports is relatively short." *Id.* In addition, supporting the court's conclusion was the fact that the individual in charge of May's intimate apparel business was only subject to a six-month noncom-

pete agreement. By the time the trial court issued its ruling, nearly six months had already elapsed since the senior executive had left May. As a consequence, there was no longer any independent economic value that could be derived from the disclosure or use of the information by the executive to Victoria's Secret. Thus, the *Victoria's Secret* case illustrates the need for counsel to be prepared to articulate how and why the information your client says needs protecting is both confidential and valuable.

Customer Relationships and Goodwill

Some jurisdictions allow for enforcement of a noncompete agreement if the former employer can show that the employee developed relationships with customers, which in turn would allow the employee to use those relationships or that goodwill to divert customers.

Courts have provided common sense rationales for enforcing noncompetes in such circumstances. For example, one court of appeals noted:

The rationale for protecting 'customer contacts' is that, in the sales industry, the goodwill toward a company is often attached to the employer's individual sales representative, and the employer's product becomes associated in the customer's mind with that representative. The sales employee is thus placed in a position to exert a special influence over the customer and entice that customer's business away from the employer. Because it is this special influence that justifies enforcement of noncompete covenants, the quality, frequency and duration of employee's exposure to the customers is important in determining the reasonableness of the restriction.

Easy Returns Midwest, Inc. v. Schultz, 964 S.W.2d 450, 453 (Mo. App. E.D. 1998) (citing *Continental Research*, 595 S.W.2d at 400-01).

One recent Eighth Circuit case analyzing whether the former employer possessed a protectable interest in its customer relationships is *Emerson Electric Co. v. Rogers*, 418 F.3d 841 (8th Cir. 2005). In that case, the defendant was a former sales representative of Emerson Electric for the sale of the company's ceiling fans to retailers throughout the southeast United States. He signed a noncompete agreement that prohibited

him from working in the same sales territory for any company selling products competitive with those manufactured by Emerson Electric. The defendant terminated his employment with Emerson and he began to sell the ceiling fans of a competitor in the same territory.

Emerson succeeded in obtaining injunctive relief against its former salesman in the federal district court. The former salesman argued that the noncompete agreement was unenforceable because Emerson did not have a protectable interest at stake. In support of his argument, the former employee purported to present facts that he sold different types of products from different manufacturers to the same customers, which resulted in the customers not necessarily associating him with any particular manufacturer. In addition, he introduced some evidence that he had relationships with many of the customers prior to his employment with Emerson. The district court rejected his arguments, specifically noting that the evidence showed that he had a "special influence over Emerson's customers." *Id.* at 845. The Eighth Circuit upheld the district court's decision.

Reasonable in Scope

In addition to an employer needing to show the existence of a protectable or legitimate interest, to be enforceable, a noncompete agreement must generally be reasonable both in duration and geographic scope. However, even in cases in which the time or geographic scope in the agreement is unreasonable, in many jurisdictions the courts will "blue pencil" (re-write) the relevant provisions of the agreement to make them reasonable in the eyes of the court rather than deny enforcement altogether. Other jurisdictions, however, do not allow courts to blue-pencil noncompete agreements or permit only a very limited form of blue penciling, with the result being their refusal to enforce an overly broad restriction. In those jurisdictions, therefore, it is even more critical for employers to ensure their agreements are narrowly tailored.

Again, the courts are typically concerned about protecting an employer from *unfair* competition by a former employee, but do not want to impose unreasonable restrictions on the employee. Thus, in most jurisdictions, the trial court will look to the

circumstances of each case to determine whether the restrictions in the noncompete are tailored to protect the legitimate interests of the employer. In some jurisdictions, geographic reasonableness may be determined by the location of the employee's job, the location of the customers of the company, the location of the customers serviced by the employee, and the position of the employee within the employer's organization.

Factors for temporal reasonableness may include the length of the employee's service with the employer, the level of the employee in the company and the length of time during which any trade secrets giving rise to enforcement are expected to remain economically valuable to the employer.

Defenses to the Enforcement of Noncompetes

As one would expect, the best defense in attacking the enforceability of a noncompete agreement is often the argument that the former employer does not have a legitimate or protectable interest (trade secrets or customer relationships) giving rise to enforcement. However, depending on the case, the defenses set forth below may also have merit.

Prior Material Breach and Unclean Hands

Where an employer materially breaches an employment agreement, it will likely be barred from enforcing its noncompete agreement. See *Ozark Appraisal Service, Inc. v. Neale*, 67 S.W.3d 759, 764–65 (Mo. Ct. App. 2002); *Galesburg Clinic Ass'n v. West*, N.E.2d 1035, 1036–37 (Ill. Ct. App. 1999) (material breach of partnership agreement operated as discharge of duties under noncompete). The underlying policy is obvious: "A party to a contract cannot seek to enforce its benefits where he is the first to violate its terms." *Ozark Appraisal Serv.*, 67 S.W.3d at 764.

The defense is often raised when an employer is alleged to have unilaterally changed the terms and conditions of the employee's employment, contrary to the terms of the parties' employment or compensation agreement. The defense is also often raised when a dispute has arisen as to whether commissions are owed to a departing salesperson. Employers should know that if they stand their ground on a compensation issue and do not pay the amount

demanding by a former employee, if a court later determines that the employee should have been paid, the employer may not be able to enforce its noncompete agreement with that employee. In short, if an employer believes enforcing a noncompete against a particular employee is important, it should consider paying the employee any amounts due and owing and, if appropriate, sue for

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The former employer "must do more than assert that a skilled employee is taking his abilities to a competitor."

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damages.

As a general note, there is a well-known adage that for one to seek equity, he or she must do equity. Stated another way, "[a] court of equity will not aid a party who resorts to unjust and unfair conduct." *McKnight v. Midwest Eye Institute*, 799 S.W.2d 909, 917 (Mo. App. W.D. 1990) (citation omitted). Cf. *International Bus. Machs. Corp. v. Martson*, 37 F. Supp. 2d 613 (S.D.N.Y. 1999) (indicating availability of unclean hands defense to noncompete in certain circumstances); *Intellus Corp. v. Barton*, 7 F. Supp. 2d 635, 644 (D.Md. 1998) (court enforced noncompete even though defendant alleged former employer failed to pay all commissions due, because the court had "not been adequately informed of the relevant facts"). See also *State ex rel. Leonard v. Sherry*, 137 S.W.3d 462, 471 n.8 (Mo. 2004) ("[t]he chief remedial defenses to equitable claims are the unclean hands defenses and laches") (internal citations omitted). Thus, whether or not an employee can prove a technical prior material breach, he may still raise the defense of unclean hands against an employer.

Termination without Cause

Depending on the jurisdiction, one of the first issues that counsel must often attempt to resolve in these cases is whether the employee's employment was terminated with or without cause. In some jurisdictions, if

the employer discharges an employee without cause, a court of equity may refuse to order injunctive relief to enforce the employee's noncompete. See, e.g., *In re UFG INT'l, Inc.*, 225 B.R. 51, 55 (Bankr. S.D.N.Y. 1998) (an employee's otherwise enforceable restrictive covenant is unenforceable if the employee has been terminated involuntarily, unless the termination is for cause); *Property Tax Representatives v. Chatham*, 891 S.W.2d 153, 156 (Mo. App. W.D. 1995); see also *You're Fired! And Don't Forget Your Noncompete...: The Enforceability of Restrictive Covenants in Involuntary Discharge Cases*, 1 DePaul Bus. & Com. L.J. 1 (Fall 2002). A defense based on an employee's termination without cause is interrelated with the unclean hands defenses and finds its basis in the general principle cited above that for one to be entitled to equity, he or she must do equity.

What is cause? Cause has been defined to mean cause *attributable to the employee*, and includes insubordination (*i.e.*, the failure of the employee to obey the lawful and reasonable rules and instructions of the employer), incompetence and negligence. See, e.g., *Superior Gearbox*, 869 S.W.2d at 244 (stating also that "lying, stealing, repeated absence or lateness, destruction of company property, brawling and similar infractions are grounds for discharge for cause").

Lack of Consideration

A court will not enforce a noncompete clause if there is no consideration for it. However, many jurisdictions have held that employment or continued employment in exchange for the noncompete is a sufficient basis to support a finding of consideration. In those jurisdictions, therefore, it is rare that this defense is successful. However, several jurisdictions provide that continued employment is not sufficient consideration and that some additional benefit must be conferred on the employee. Counsel should therefore ensure that any noncompetes implemented are supported by adequate consideration under the applicable states' laws.

Waiver

One of the defenses sometimes raised to the enforcement of a noncompete agreement is that the former employer has not

enforced its noncompete agreements in the past against other employees and has thus waived enforceability. The success of this defense is fact specific. It will depend largely on the number of the past instances of failing to enforce the noncompete, how recent those instances are, and whether the other employees had the same type of job or similar ability to harm the company as the employee at issue.

A former employee will often argue that, since the employer has failed to enforce noncompete agreements against other employees with similar access to confidential information and similar customer contacts, the employer itself does not truly believe that it has protectable interests in its confidential information or customer contacts worthy of protection. In such cases, the employer will often try to explain to the court why the situations are distinguishable. In addition, the employer will often seek to have the court exclude evidence of the enforcement (or lack thereof) of other noncompete agreements so as to avoid a series of mini-trials on why enforcement was not pursued in each case.

Assignability of Noncompetes

In a business world in which corporate mergers and the sales of businesses are very common, an issue of ever increasing relevance is the ability of the new entity or employer to enforce noncompete agreements originally entered into between an employee and the original (or old) employer. Indeed, it goes without saying that a non-competition agreement is a valuable asset of a business that is likewise viewed as a valuable asset to a prospective business purchaser or candidate for merger. What happens to the noncompete agreement when there is a change in control or ownership of the business? Can the new entity or owner enforce the agreement?

Assignments in General

Under some states' laws, employer-related agreements are considered "personal services" contracts, which means they cannot be assigned without the consent of the employee. Before attempting to effectuate any assignment of a noncompete, therefore, counsel should determine whether consent of the employee is required in the relevant jurisdiction.

"Assignment" in the Case of a Statutory Merger

However, in most states, noncompete agreements are generally enforceable in the case of a statutory merger or stock sale. Indeed, in the case of a statutory merger, the new entity or employer is the successor to the rights and liabilities of original employer, and notwithstanding the law of assignments, in most jurisdictions, the noncompete agreement remains in full force and effect after the merger. As stated by one state Supreme Court:

[T]he surviving corporation in a merger assumes the right to enforce a noncompete agreement entered into with an employee of the merged corporation by operation of law, and no assignment is necessary. This is because in a merger, the two corporations in essence unite into a single corporate existence.

Accordingly, based on fundamental principles of commercial transactions and the applicable statutes, we hold that, in contrast to an asset purchase, neither a 100 percent purchase of corporate stock nor a corporate merger affects the enforceability of a noncompete agreement... This holding also 'conforms with the policy of preserving the sanctity of contract and providing uniformity and certainty in commercial transactions.'

Corporate Express Office Products, Inc. v. Phillips, 847 So. 2d 406, 413-15 (Fla. 2003). See also *Alexander & Alexander, Inc. v. Koelz*, 722 S.W.2d 311, 312-13 (Mo. Ct. App. 1986) ("a change in the form in which the employer does business such as [a statutory] merger... while involving a formal transfer from one entity to another, should not be seen as creating an assignment in violation of the rule against the assignment of personal service contracts").

The court went on to reject the notion that a purported change in culture and mode of operation at the new entity somehow invalidates a noncompete agreement.

Choice of Law

One might ask whether a concern about other states' noncompete laws is warranted given that a choice of law provision can be included in any noncompete. While choice of law provisions generally are, and should be, used, depending on the jurisdic-

tion, your client's choice of law may not be enforced by the local courts.

In many jurisdictions, the courts follow the Restatement (Second) of Conflicts of Law, §187, in determining whether a choice of law provision should be upheld. The Restatement provides that the law chosen will govern the parties' relationship unless: (a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice; or (b) application of the law of the chosen state would be contrary to a fundamental policy of a state having a greater material interest in the issue than the chosen state and such state would be the state of applicable law absent the choice made by the parties. See, e.g., *Jarvis v. Ashland Oil Co.*, 478 N.E.2d 786 (Ohio 1985). The latter point can be critical in the noncompete context, as even jurisdictions providing for limited enforcement of noncompetes may refuse to apply the law chosen by the parties in their agreement on public policy grounds. See, e.g., *Keener v. Convergys Corp.*, 582 S.E.2d 84, 87 (Ga. 2003) (Georgia law applied even though Ohio law chosen by the parties). Thus, counsel should ensure that a noncompete agreement used in multiple states is appropriately implemented and drafted for jurisdictions that may refuse to enforce choice of law provisions in such agreements. This is particularly important with respect to the issue of adequate consideration and in jurisdictions where the courts refuse to blue-pencil overbroad agreements (see above).

The New Employer's Exposure

The former employer often files suit against its former employee and the new employer. There are a number of strategic considerations concerning whether the new employer should be sued at the outset of the litigation, added later in the litigation or sued at all. Those strategic considerations vary on a case by case basis. However, there are a number of theories of recovery to which the new employer may be exposed, including civil conspiracy, tortious interference with a contract or business expectancy, misappropriation of trade secrets under the UTSA and computer tampering or computer fraud claims (see below).

In addition to being exposed for damages for the lost profits of the former employ-

er's customers diverted in violation of a noncompete agreement, the new employer may also be liable for the attorneys' fees incurred by the former employer to enforce the noncompete. In some jurisdictions, where one tortiously induces another to breach a contract, the harmed party may, in an action against the tortfeasor, recover attorneys' fees incurred in prosecuting an action for damages or specific performance against the breaching party. See, e.g., *Nepera Chemical, Inc. v. Sea-Land Service, Inc.*, 794 F.2d 688, 696–97 (D.C. Cir. 1986); *Phil Crowley Steel Corp. v. Sharon Steel Corp.*, 536 F. Supp. 429, 431 (E.D. Mo. 1982) (quoting Restatement (Second) of Torts §914(2) (1979)), *aff'd*, 702 F.2d 719 (8th Cir. 1983). See also 25 C.J.S. Damages, §50. In other words, an award of attorneys' fees is arguably appropriate because, if the new employer did not interfere, there would not have been litigation between the former employer and employee. This is known as the "collateral litigation doctrine," which is an exception to the American Rule that provides that attorneys' fees are only recoverable when provided for by a contract or statute.

When a new employer is considering hiring someone who has a covenant not-to-compete, consideration should be given to the new employer's exposure in hiring the employee, particularly if the goal is to have the employee solicit customers of the former employer.

Computer Tampering and Computer Fraud Statutes

In cases involving stolen documents or computer data, an employee (and in some cases even a new employer) may be exposed to criminal penalties under the relevant state's computer tampering or computer fraud statute. Indeed, most jurisdictions criminalize certain types of conduct related to the taking or destroying of data residing on computers. Importantly, several jurisdictions provide for additional civil liability for violating these statutes, including the remedies of injunctive relief, compensatory damages and/or attorneys' fees.

The importance and value of such statutes to employers seeking to protect themselves against unfair competition cannot be overstated in an age in which communications, customer data and other valuable

company information are, more often than not, maintained and transmitted electronically. The civil remedy provisions of these statutes can provide a real sword against the departing employee against whom a cause of action under a noncompete may either not exist or may otherwise be weak. However, not only should in-house counsel be aware of these statutes as a potential theory

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of recovery, but should also beware when hiring employees from the competition.

Duty of Loyalty

In some jurisdictions, employees—whether or not subject to noncompete agreements—still owe their employers a duty of loyalty. See, e.g., *Scanwell Freight Express STL, Inc., v. Chan*, 162 S.W.3d 477, 479 (Mo. 2005). See also Restatement (2d) Agency, §393 (1958). The "most common manifestation of the duty of loyalty" is that "an employee has a duty not to compete with his or her employer [during his employment] concerning the subject matter of the employment." *Id.* (citing Restatement (2d) Agency §393 (1958)). A breach of the duty of loyalty may arise "when the employee goes beyond the mere planning and preparation [to leave] and actually engages in direct competition, which, by definition, is to gain advantage over a competitor." *Id.*

The Checklists

Protecting Confidential Information

Adequately protecting valuable business information is critical to preventing an employee from engaging in unfair competition. The following are basic steps almost any company can take to: (a) limit the ability of employees to take information in the first place, and (b) increase the company's chances to stop the employee's bad conduct.

- Implement confidentiality agreements for employees (or include confidentiality provisions in the noncompete) and third parties (e.g., vendors).

- Implement confidentiality policies as part of employee handbooks, and ensure employees acknowledge receipt of the policies. Any confidentiality policies and confidentiality agreements should be consistent.

- Define "confidential information." Take a moment to consider the types of confidential information your client actually possesses and ensure that information is adequately covered in the definition of confidential information you have in your policies and agreements.

- Provide periodic reminders of confidentiality policies and agreements.

- Mark confidential documents "CONFIDENTIAL".

- Keep "confidential" documents secure (e.g., locked file cabinet or locked office).

- Limit the number of copies of sensitive information; shred excess copies.

- Require password access to the company computer system and, importantly, additional password access for a more limited set of employees for files or sections of the system containing company trade secrets. If practical, password access to such documents should be on a need-to-know basis.

- Establish policies or procedures to prevent confidential material from being disclosed to the public, such as in trade publications and speeches, and at seminars and trade shows.

- Use exit interviews and follow-up letters to remind ex-employees of their obligations under their noncompetes and confidentiality agreements and try to determine whether their future employment plans pose a risk of breach of their obligations.

Drafting Effective Noncompete Agreements

It is clear that noncompetes can be effective in preventing unfair competition. However, the agreements should be drafted in a manner calculated to be enforceable under the applicable states' laws. In that regard, note the following suggestions for drafting noncompetes:

- Choice of law. Include a choice of law provision that is favorable to enforcement of noncompetes and that has a legitimate connection to the parties.

■ Check the other states' laws. If you have employees in multiple states, see if your noncompetes are enforceable in each state and, if not, whether that state's conflict of laws rules would allow for your chosen state's law to be enforced. Don't allow your company to be caught unprotected in a jurisdiction simply because a more narrowly tailored noncompete was not used.

■ Draft reasonable restrictions. Particularly if the state law is not favorable to blue-penciling overbroad restrictions, ensure the restrictions are realistic and reasonable in light of the circumstances.

■ Include non-solicitation of customers (if applicable) and anti-employee raiding provisions in addition to noncompete language, so that if the noncompete portion of the agreement is not enforced, the court will still have the option to enforce the other provisions.

■ Include a severability provision, including language specifically allowing a court to blue pencil the agreement to make it reasonable.

■ Include a prevailing party attorneys' fees provision.

Avoiding Unfair Competition When Hiring

There are several easy steps that may greatly reduce the new employer's exposure to unfair competition litigation brought by a competitor. The following policies or practices are suggested when hiring any employee who previously worked for a competitor:

■ Ask the candidate in writing for a copy of any noncompete agreement or other restrictive covenant. If there is a restrictive covenant and the business people want to hire the person, the best practice would be to seek legal counsel so that the risk associated with the hiring can be considered.

■ If the new employee states he or she had no noncompete or other restrictive covenant with his or her prior employer, confirm that in writing in the offer letter or subsequent writing to the employee. This can be documented as a term in an employment agreement or noncompete agreement.

■ Unequivocally instruct the new employee that he or she should not take, use or disclose any confidential information or trade secrets of his or her previous employer. This should be documented in

writing as a term in an employment agreement or noncompete agreement.

■ If the employee has a restrictive covenant that does not prohibit his or her employment with the new employer, but which does impose other restrictions, make the employee's employment conditional on the adherence to those restrictions.

Conclusion

In jurisdictions where noncompetes are often enforceable, the basic principle to remember is that courts will enforce a noncompete agreement only to protect a former employer from *unfair* competition. Without the existence of the protectable interests of trade secrets or customer relationships, the noncompete is not likely to be enforced.

Counsel must also be mindful that, even without a noncompete agreement, a cause of action may still lie to prevent unfair competition under other theories, including trade secret misappropriation under the UTSA, breach of the duty of loyalty and violations of state computer tampering and computer fraud statutes. 