Keeping it Real and Reasonable

Crafting and Defending a Post-employment Restrictive Covenant

by Edward T. Kole and James E. Tonrey Jr.

Restrictive covenants are crucial instruments for companies seeking to protect their most critical assets, such as contacts, trade secrets, technologies and other intellectual property. But walking the fine line between an individual's livelihood and a company's competition is tricky. Indeed, while New Jersey's highest court has repeatedly affirmed that such covenants are enforceable, the central issue in most restrictive covenant cases is not whether an employee has *breached* the covenant, but whether the covenant is *enforceable*. Given the high standards, employers should include—and hone—those collateral provisions in the employment agreement that provide a post-employment restriction its best chance of enforcement.

The Well-Known Standard

The general standards applicable to post-employment restrictive covenants are well known. Restrictive covenants are enforceable if they are reasonable in view of all the circumstances of the particular case.[1] In determining whether any particular restriction is reasonable, courts consider the following factors: 1) whether the restriction protects a legitimate interest of the employer; 2) whether the restriction imposes undue hardship on the employee; and 3) whether the restriction is injurious to the public.[2] The problem is not usually with what the standard requires, but that the standard in many cases cannot be met.

Problems with restrictive covenant enforcement actions often arise from the absence of a practical mindset throughout the process. From the time a restrictive covenant is drafted for inclusion in an employment contract, through the performance of that employment, until the end of that employment relationship, be it an amicable ending or not, attention should be paid to the following considerations.

Does the Restriction Protect a Legitimate Interest of the Employer?

Whether the employer has a legitimate business interest in enforcing the restrictive covenant will be one of the court's principal concerns in any enforcement action. It is important to keep this factor in mind throughout the lifecycle of the covenant. Employers should consider whether the restrictive covenant should contain some substantive information about the employer's business, the competitive environment in which the covenant is located, and provide examples of harm that could befall the company if the covenant is breached. Boilerplate statements or stipulations are easy for a court to brush aside. The more specific a restrictive covenant is in describing the nature of the employer's protectable business interest, the more likely a court may be to find a legitimate business purpose.

At the same time, employers should remain realistic and practical. A common and entirely understandable theme in restrictive covenant cases is the employer who wants immediate court action to restrain a former employee from contacting the employer's clients. Before money, time and effort are invested in filing a lawsuit seeking emergent relief, the employer must be clear that it has a legitimate business interest in preventing the former employee from communicating with clients.[3]

It is well settled that an employer does not have a legitimate interest in simply restricting competition.[4] If the clients the former employee are contacting are publicly known individuals or entities—those any person conducting an Internet search could identify—a court is unlikely to find the employer has a legitimate business interest in preventing contact. As a practical matter, counsel should make this determination before rushing to court, because the court may deny the application on this ground alone.[5]

To be protectable as a legitimate business interest, the information or clients the employer is attempting to protect must constitute company-specific, confidential know-how information at the core of the business. The Court in *Whitmyer Bros, Inc. v. Doyle* provided a helpful discussion on what may and may not constitute legitimate business interest.[6] In that case, the Supreme Court of New Jersey explained:

> The employer's legitimate interests in protecting his trade secrets and the like have been long recognized even in cases without noncompetitive agreements though reasonably confined noncompetitive agreements may properly serve to avoid difficulties of definition and proof. However, matters of general knowledge within the industry may not be classified as trade secrets or confidential information entitled to protection nor will routine or trivial differences in practices and methods suffice to support restraint of the employee's competition.
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> In *A. Hollander & Son, Inc. v. Imperial Fur Blending Corp.*, 2 N.J. 235, the Court enforced a restriction against postemployment competition. Though the opinion contains some ambiguous expressions, the facts relied on bring the case fairly in line with *Solari,* 55 N.J. 571 and with what has been said earlier in this opinion with respect to the protection of the legitimate interests of the employer. The Court in *Hollander* specifically noted that the employee there "was placed in a special position to learn the various secret formulae and processing methods" of the employer; through "possession of the formula books and supervision of the dye house, he became intimately acquainted with and fully cognizant of the very core" of the employer's successful operations; and through his discovery of a new dye formula, which under the terms of the employment became the sole property of the employer, he had confidential information which he had used in competing with his employer. 2 N.J. at 249.

Enforcing the Covenant upon an Employee's Departure

Counsel should ensure the employer is aware he or she does not have the luxury of selectively enforcing post-employment restrictive covenants. For example, Employee A has a post-employment restrictive covenant, is in possession of confidential information, and left the employer to join a competitor, but the employer did not attempt to enforce the covenant because Employee A is not perceived as a threat. The employer should be made aware that the decision not to enforce the covenant against Employee A could have detrimental consequences in later years if Employee B, who also has access to confidential information, leaves to join a competitor and *is* perceived as a threat by the employer.

In a lawsuit to restrain Employee B from joining the competitor, a court could find the employer's selective enforcement of the restrictive covenant demonstrates the employer does not have a legitimate business interest in enforcing the covenant. Failure to enforce the covenant against Employee A demonstrated the information was not important and the enforcement of the covenant is more of a personal vendetta against Employee B. By deciding not to pursue enforcement against Employee A, the employer may have inadvertently damaged the chances of enforcing the covenant against other employees. An employer should be advised of this potential pitfall when the restrictive covenant is drafted.

In a perfect world, an employer might file a lawsuit every time an employee accepts employment in violation of a restrictive covenant. However, judicial action is not always the best option in light of costs and other considerations. There is action an employer may take in attempting to enforce a restrictive covenant—short of filing a lawsuit—that may suffice to avoid waiving the legitimate business interest a restrictive covenant may protect. For instance, an employer can provide the departing employee with a letter demanding the employee and/or new employer immediately cease and desist from the conduct at issue, and seek written confirmation from the former employee and the new employer. While there is no case law approving this practice in lieu of filing a lawsuit to enforce, it appears reasonable that where filing a lawsuit may not always be the best option, counsel has taken action in the past on behalf of the employer, and demonstrated there is a legitimate business interest for the restrictive covenant.

Is the Covenant Reasonable Regarding Geographic Scope and Duration?

In assessing the reasonableness of the restrictive covenant, a court will also examine the scope and duration. Ordinarily, a post-employment restrictive covenant must be narrowly tailored to protect the legitimate interest of the employer. With respect to the duration of a restrictive covenant, employers obviously want a restriction that lasts forever. However, a perpetual restrictive covenant is not reasonable because an employer ordinarily would not have a legitimate business interest in restricting the employee forever. Instead, employers must consider factors such as the timeframe for the employee to develop a technology, process, business or business relationship on his or her own and tailor the duration of the restriction accordingly. In other words, if it would take the employee a year to develop the relationships and knowledge he or she acquired while at the former employer, a year would seem a reasonable duration for the restriction. It also might be wise

to include a provision in the agreement in which the employee stipulates to the time it would take to develop the relationships and knowledge.

Similarly, a court will also examine the reasonableness of the geographic restriction contained in a post-employment restrictive covenant. Once again, there is little doubt an employer would want a restriction with a large geographic scope, such as a 100-mile radius from each of the employer's offices. Practically, however, there may be no need for a 100-mile restriction if the employer's customers are clustered within a five-mile radius of the offices of the business. To this end, employers should design a reasonable geographic restriction that is in line with the company's customer/revenue base. It may also be advisable to include in the employment agreement a provision in which the employee stipulates that most customers are within a certain radius of the business and that a restriction of this radius would be reasonable and necessary to protect the employer's business.

Can the Irreparable Harm Requirement be Met?

In situations involving breach of a post-employment restrictive covenant, employers often seek expedited relief in the form of a preliminary injunction by filing an order to show cause. This requires the employer demonstrate it faces immediate, irreparable harm if the court does not enter a preliminary injunction and/or temporary restraints.[7] Courts focus on the presence of irreparable harm at the outset and often deny applications for relief in light of a party's failure to demonstrate irreparable harm. In other words, if an employer desires an injunction, and has the proofs to get one, the employee needs to seek relief in court quickly. As the old adage goes, equity aids the vigilant not those who sit on their rights.

Moreover, effectively demonstrating irreparable harm should be taken into consideration in the drafting of restrictive covenants and in efforts to enforce them. For instance, it is well settled that irreparable harm cannot be compensated by monetary damages. Therefore, employment agreements containing post-employment restrictive covenants must not include any provisions in the agreement that may be inimical to the presence of irreparable harm, such as a liquidated damages clause. A liquidated damages clause in which the employee stipulates that, upon breach of the agreement, a specified monetary amount will be paid to the employer as damages is inconsistent with, and may preclude an award of, irreparable harm. The inclusion of this liquidated damages award in the employment agreement may inadvertently preclude the employer's ability to obtain a preliminary injunction in the event of a need to enforce the restrictive covenant on an expedited basis.

Conclusion

Recognizing that the restrictive covenant is in place to be enforced, and that courts will not enforce these covenants unless they comport with the appropriate standards, employers must be mindful of the standards to provide the covenant with its best chance of enforcement. No one can predict whether a particular restrictive covenant will be enforced, but the practical considerations discussed here provide a sensible, standard-driven approach that will make it easiest for a court to enforce these covenants.

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ENDNOTES

1. *Solari Industries. Inc. v. Malady*, 55 N.J. 571, 576 (1970); *see also Whitmyer Bros. Inc. v. Doyle*, 58 N.J. 25, 32 (1971).
2. *Whitmyer Bros. Inc. v. Doyle*, 58 N.J. at 32-33; *Karlin v. Weinberg*, 77 N.J. 408, 412 (1978); *Ingersoll-Rand Co. v. Ciavetta*, 216 N.J. Super. 667, 671 (App. Div. 1987).
3. The Supreme Court of New Jersey has noted that general knowledge in an industry is not a legitimate business interest sufficient to support enforcement of a restrictive covenant:

   > Generally, how much protection is needed by an employer depends upon the legitimate interests for which he may claim protection. Legitimate interests is only another term to describe those "special circumstances" which render an employee's restraint necessary, but protection against ordinary competition itself is not sufficient. The authorities indicate that the "special circumstances" which have been controlling and important in determining the reasonableness of the restraint imposed generally involve elements of trade secrets and unfair dealings.
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   > In ***Dunfey Realty Co. v. Enwright, supra,*** 101 N.H. 195, 138 A.2d 80, the trial court found that there were no trade secrets or confidential materials which the employee could use to his former employer's detriment and refused therefore to enforce a postemployment restrictive covenant. This was affirmed in an opinion which held that the employer "must show more than that its methods and procedures were not known to the general public. It must establish that such secrets were exclusively its own and not general secrets of the trade." 138 A.2d at 83. In ***Aetna 37*37 Bldg. Maintenance Co. v. West, supra,*** 39 Cal.2d 198, 246 P.2d 11, the court found on the evidence before it that the employer's procedures for estimating prices on new contracts for janitorial service and building maintenance were not trade secrets or business confidences. 246 P.2d at 16. And in ***McLeod v. Meyer, supra,*** 237 Ark. 173, 372 S.W.2d 220, the court expressed the thought that knowledge which the employee had gained as to how to bid for a job of clearing rights of way and keeping them clear was hardly to be classified as a secret formula but was simply the knowledge "which one acquires by experience" in the trade. 372 S.W.2d at 223. (***Whitmyer Bros., Inc. v. Doyle, et al.,*** 58 N.J. 25, 336-37 (1971)).
4. *Whitmyer Bros., Inc. v. Doyle, et al.*, 58 N.J. 25, 33 (1971). In *Whitmyer Bros.*, the Court explained that while an employer does not have a legitimate interest in restricting competition, the employer does have legitimate interests in protecting its proprietary information and customer relationships, explaining as follows:

   > The employer has no legitimate interest in preventing competition as such; the authorities generally recognize this...and the underly-

ing policy finds recent legislative expression in New Jersey's Antitrust Act. L. 1970, c. 73; N.J.S.A. 56:9-1 *et seq.* But the employer has a patently legitimate interest in protecting his trade secrets as well as his confidential business information and he has an equally legitimate interest in protecting his customer relationships. *Id.*

5. The employer will no doubt want to prevent the employee from contacting the customers; but relying upon the restrictive covenant in such circumstances when the customers are generally known may not be the most effectual course of action. As a practical matter, the practitioner may consider whether an argument based on breach of the employee's duty of loyalty would fare better. *See Cameco v. Gedicke*, 157 N.J. 504, 517-18 (1999) (discussing parameters of breach of duty of loyalty claim). It is well settled that an employee owes such a duty to the employer. In cases where the clients are well-known in the public, it may be a better course to develop facts to determine whether the former employee breached his or her duty of loyalty to the employer by, for example, removing from the former employer address lists, customer lists or the like, and relying upon such information before the Court.
6. *Whitmyer Bros., Inc. v. Doyle*, 58 N.J. 25, 33-34 (1971).
7. *Crowe v. De Gioia*, 90 N.J. 126, 132-33 (1982) ("Harm is generally considered irreparable in equity if it cannot be redressed adequately by monetary damages.").