



Restrictive Covenants Can Swing Both Ways: A 3-Step Plan To Avoiding Legal Risks When Onboarding New Employees

Insights

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Employers have been using restrictive covenant agreements – contracts that contain non-compete, customer non-solicitation, employee non-solicitation, or non-disclosure of confidential information – with increasing frequency in recent times. Increased media attention on the practice of forcing lower-level employees to sign non-compete covenants, combined with the widely publicized report on non-compete restrictions issued by the Obama White House in its waning days, has led to an increase in the number of reported cases. Further, several states are passing new laws or considering changes to existing laws on the subject.

These agreements can benefit your company by protecting key relationships, preserving your investment in training, and shielding confidential information from disclosure. The downside, however, is that recruiting talent into your organization has become more complicated because your competitors are likely also using restrictive covenant agreements. Thus, it is important to employ best hiring practices, especially with higher-level employees brought over from competitors. Here are three basic steps your company can take to reduce the chances of a lawsuit from a competitor, or at least put you in a favorable position if litigation is threatened.

1. Ask Questions On The Front End

Some employers take a “hear no evil, see no evil” approach with respect to restrictive covenants for incoming employees. While this can be a technical defense to a tortious interference claim, it is not a good overall legal strategy for several reasons. First, many courts will conclude that you should have asked questions about restrictive covenants on the front end, treating failure to do so as willful blindness. Second, your company is unlikely to be better off if it hires someone who soon gets saddled with a court injunction preventing that new employee from working for you. The lost training time, cost of finding a replacement, and the reputational effects of being defeated by a competitor can outweigh the value of sticking your head in the sand.

Additionally, the information your company can gain by asking questions during the recruiting process could generate effective legal strategies. You might learn that the restrictive covenant itself, or the facts and circumstances surrounding an employee’s work and departure from a former employer, can create legal defenses. This is especially true given that state laws vary significantly with respect to restrictive covenants, some of which limit the enforceability and scope of them. Some common examples:

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- Did the former employer terminate the employee without cause or demote the employee before departure?
- Did the former employer engage in some form of illegal or unethical behavior that could form the basis of an unclean hands defense?
- Has the former employer allowed other employees to leave and violate agreements without taking steps to enforce its contractual rights?

Uncovering more information can be useful in creating legal defenses or, at a minimum, establishing leverage in the event you need to negotiate with a competitor regarding the employee's move to your company.

2. Structure The Job On The Front End To Ensure Compliance

The two most basic questions when considering hiring an employee subject to contractual limitations are:

- Is the agreement enforceable, either as written or in a form in which a court is likely to modify?
- Can you hire the employee in a way that will comply with the covenants?

You can get answers to the first question by working with your lawyer to develop a list of probing questions to ask on the front end, as described above. You can get answers to the second question, and ensure compliance with any relevant restrictions, by structuring the incoming employee's position in a thoughtful way. You should balance the demands imposed by any valid restrictive covenant with your business needs to get maximum productivity.

Some basic ways to address restrictive covenant issues when crafting a position for a new employee include changing the employee's duties and territory so they are not engaging in the same tasks or working the same area as they did for their former employer; restricting the employee from soliciting clients with whom they were in contact on behalf of a former employer; and having the employee sell or provide products or services that are not competitive with those offered by a former employer.

It is important to bear in mind that these restrictions are temporary, as restrictive covenants rarely last longer than two years. If you expect your new employee will be a benefit to the organization and will spend a long time with your company, one or two (or often fewer) years of restrictions is a reasonable price to pay to acquire a talented, hard-working person. This is a situation where long-term thinking is often rewarded.

3. Emphasize The Importance Of Purging All Former Employer Materials

In an era where a thumb drive can contain the equivalent of dozens of bankers boxes of documents, and the cloud allows for virtually limitless data storage, it is easy for employees to walk out the door with a massive amount of a former employer's materials. Employees sometimes do so intentionally, but more often than not, the retention of materials is inadvertent. Nevertheless, it is easy work for computer forensic experts to find evidence that such materials were taken, so even inadvertent misappropriation can be costly.

Accordingly, it is critical that you emphasize to incoming employees – both in writing and verbally – that they are to complete a thorough review of their possessions and return all such materials to their former employer. The review should include their home computer, external hard drives, thumb drives, cloud-based accounts (such as contacts in the iCloud), and the proverbial box of documents in the garage. Employees often have a limited sense of what belongs to their former employers and commonly make the “I-made-it-therefore-it-belongs-to-me” mistake. You should be proactive to disabuse incoming employees of this notion because retention of former employer materials can create expensive lawsuits and accompanying headaches.

Free Comprehensive Checklist

Our firm's Employee Defection and Trade Secrets Practice Group has developed a free, comprehensive checklist for you to use when recruiting employees from a competitor. The checklist is a point-by-point way to reduce the chances of being sued. If you are interested, please reach out to your Fisher Phillips attorney, or any member of the practice group, and ask for a complimentary copy.

For more information, contact the author at MElkon@fisherphillips.com or 404.240.5849.

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