NON-COMPETE AGREEMENTS MYTHS, LEGENDS AND DANGEROUS ASSUMPTIONS

How some businesses let ex-employees waltz out the door with the keys to their success

HARTFORD, CT, Sept. 25, 2006 -- Common knowledge is that non-compete agreements are unenforceable, so why bother with them? This is the business version of an Urban Legend. It s been repeated so often that people believe it, but it s simply not true, says Elizabeth J. (E.J.) Robbin, a partner in the Business, Corporate and Commercial Law practice of Rogin Nassau Attorneys at Law. Non-compete agreements are absolutely enforceable as long as they are done properly. Any company that believes it has a competitive advantage should consider using them to protect themselves from ex-employees who can walk out the door with the keys to their kingdom in their heads.

Employers invest a lot of time and money in their employees. But the law says that they are at will . This means that either employers or employees can end the relationship at any time for any reason or no reason. Employers do not want the employees they ve trained to go next door to the competition, taking their secrets with them. Nor do they want employees using that information to start their own competitive business. A well-constructed non-compete agreement can be the key to make sure these concerns are taken care of.

The issue of non-compete agreements is a particularly important one in today s business world. Three trends make non-competes especially important in the current business environment: A change in the definition of competition; the lack of employee loyalty; and the importance of relationship-based selling.

Atty. Robbin points out just how much the web has changed the business world: The impact of the web means that it s easier for employees to set up their own shop with the potential for worldwide exposure, she says. That means that former employees can be a threat no matter where they go. It also means that the traditional definition of competition (and an employer s ability to keep an employee from becoming a direct competitor) is complicated. Courts are reluctant to lock people out of their fields on a world-wide scope.

The lack of long-term job security is the second trend that necessitates the need for non-compete agreements. Today s shifting marketplace means that employees are less loyal to their companies and more likely to work for or become competitors, Atty. Robbin says. It used to be that employees expected to graduate from college, get a job and stay there for the rest of their working lives, she says. That s an unrealistic expectation in today s business world and both employers and employees are well aware of it.

People don t see jobs as permanent and many have no problem leaving for reasons as diverse as better titles and salaries, better health benefits and even better parking. This drastic decline in employee loyalty means that today, more than ever, businesses need to protect themselves.

The impact of relationship selling is the third trend. In many professions, who you know is more important that what you know. This means that customer lists can be the keys to success and these are easily stolen. Today, the relationships employees build with your customers are critical success factors, says Atty. Robbin. Without a non-compete agreement, any employee can use those relationships to build a business for themselves or your competitors. Why? Because a customer list is not generally seen as a trade secret and therefore not viewed by the courts as something that needs protecting.

Nobody goes to work for somebody with the expectation that it won t work out. But it happens and can result in litigation, points out Atty. Robbin. To avoid that, employers must do their best to protect themselves with non-compete agreements. If these documents don t exist or aren t well-crafted you are going to end up in litigation down the road.

There are four basic issues that an enforceable non-compete should address: the limits of time and geography that a former employee must honor to avoid a competitive situation; the consideration an employee receives for signing the non-compete; and the nature of the business in which the employee operates.

- **An enforceable agreement is limited to a reasonable time** Courts will not enforce an agreement that prohibits an employee from making a living. So non-competes should only restrict competition for a reasonable period of time. One to two years is generally enforceable. But the definition of reasonable time is very much contingent upon the industry in which the employer operates. For example, a one-to-two year restriction in manufacturing is reasonable, because the customer base and processes don t change that quickly in this environment. On the other hand, if you re in a technology business, being out of the business for that length of time might be considered to be unreasonable because of the pace of change in that industry.

- **An enforceable agreement is limited geographically** Today, this restriction has lessened in importance because more companies are doing business everywhere. However, it is still relevant in occupations that depend upon local customer contact, such as real estate agents, physicians and casualty-property insurance agents. For a non-compete to be enforceable, that restricted area should be only as broad as necessary, points out Atty. Robbin. She gives the example of a doctor who has been associated with a practice leaving to go out on his own.

The non-compete could be only small geographic market area. For a general practitioner, it might be as small as one or two miles or one or two towns. You should also note that if the agreement ends up in litigation, the court has the discretion to change that area if it s perceived to be too broad.

- **There has to be some consideration for the employee signing the non-compete** Since the employer is getting the value when an employee agrees to a non-compete there has to be something of value given in exchange. If the non-compete is done as a condition of employment at the beginning of the employee-employer relationship, this is considered to be consideration, says Atty. Robbin. If an employer institutes a non-compete after someone is on the job, some courts will allow continued employment as the consideration. Others require the employer to give something of value for signing a non-compete. What is safe is giving something tangible in response to the signing of a non-compete, such as a bonus, promotion or a raise. As a side-note, employers should know that non-competes signed under duress may or may not be enforceable. The courts haven t decided it, but we would obviously suggest an employer play it safe and handle the non-compete without exercising pressure, cautions Atty. Robbin.

- **The nature of the business can impact on a non-compete s enforceability -** Not every business can justify a non-compete. There has to be a legitimate reason for it. Businesses that want to protect their customer lists or that do business using a unique set of procedures will often benefit from letting their employees know upfront what they can and cannot do. A non-compete is a good way to do this, suggests Atty. Robbin. This is especially important because customer lists and procedures are not, by definition, trade secrets, so they are not protected in any way. By contrast, the formula for Coca Cola is a trade secret and the law provides protection against an employee revealing this information, she explains.

  In many occupations, the customer list is the secret to success. Most employers think that a customer list is confidential and that their employees know that. But that s not necessarily the case. An employee leaving to go to the competition could challenge that, saying that it s a list that anyone could build, she says. It depends on how accessible the customer list is. Does it consist of names and addresses that anyone could look up in the phone book or find on-line? Or does it include the names, addresses, home phones, work phones and a list of the insurance policies that a customer has, including a list of the expiration dates of the policies and a list of the cost of the policies? If an insurance agency distributes such a list regularly to its agents, it s going to be hard to make the case that it s confidential. There is a lot

of grey in this area of law and you need to expect that when you re trying to protect this kind of intellectual property, says Atty. Robbin. If the employer does not take reasonable steps to protect the privacy of the information with a non-compete, the court may not back them up if they try to stop an ex-employee from using it.

The same goes for companies that have created unique procedures for tackling a particular problem. For example, a manufacturing company may use a certain process or procedure to push its product through to its customers that is faster or less expensive than other similar manufacturers and that process or procedure gives it a competitive edge. If an employee learns certain ways of doing something that are unique, you don t want them going out and using those procedures anywhere else. It may be part of their job to know that information, but it may be illegal for them to use it once they leave. Employers wishing to protect themselves in this situation should specify it in their non-competes because you can t guarantee that a court will uphold your right to stop an employee from using it somewhere else.

She summarizes the need for enforceable non-competes this ways: What s in your employees head is the information your business values as its competitive advantage and you as an employer must take steps to guard it. I m reminded of a quote by the great adman, David Ogilvy, who once said Our greatest asset goes down in the elevator each night. Ogilvy knew that all employers should value the knowledge their employees possess as their most powerful asset. A well-constructed non-compete agreement is an important way to protect that asset and lock in a business competitive advantage.

Elizabeth J. Robbin is a partner in the firm of Rogin, Nassau. She practices in the areas of business and civil litigation, trials and appeals, including business, contract, real estate, and landlord-tenant disputes and the prosecution and defense of unfair competition, non-competition agreement violations, franchising and tort cases.

Rogin Nassau has offices in Hartford and New Haven. Established in 1948, the firm handles complex business, real estate and litigation matters. Their website is www.roginlaw.com