

Morgan Lewis

2013 Labor and Employment
Webinar Series

Noncompete Update

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Agenda

- Tips and Considerations Regarding Prelitigation Strategies and Procedures
- What Litigating a Noncompete Case Looks Like in Practice
- Considerations Regarding Hiring Employees with Noncompete Covenants

Tips and Considerations Regarding Prelitigation Strategies and Procedures

Prelitigation Strategies and Procedures

- Conduct due diligence before making a decision:
 - Company policies and practices re confidentiality and company property
 - Forensic examination of employee's computer and devices
 - Communications with customers/clients who may have interacted with former employee
 - Communications with employee's coworkers re activities prior to termination

Prelitigation Strategies and Procedures

- Identify the goals of litigation:
 - What form of injunctive relief is sought?
 - *Careful consideration must be given to framing relief sought to effectuate the goal and avoid overreaching*
 - *Ensure the relief sought is permissible under the applicable restrictive covenant*
 - What form of injunctive relief is realistic and likely to be granted?
 - Monetary relief that may follow or fee shifting?

Prelitigation Strategies and Procedures

- Can you demonstrate actual or imminent harm?
 - Lost customers/clients?
 - Lost business or business opportunities?
 - Confidential or proprietary information taken?
 - Lost employees?

Prelitigation Strategies and Procedures

- Must employers consistently enforce restrictive covenants every time the covenants are violated?
 - Generally no, but concerns include:
 - *Waiver*
 - *Claims of selective enforcement*
 - *Retaliation*
 - *Undermining your position*

Prelitigation Strategies and Procedures

- Assess whether your own hiring practices may undermine your ability to enforce restrictive covenants
 - Regularly hire from competitors that
 - *have similar restrictive covenants*
 - *have their own confidential/proprietary information*
 - Previous hire, now with a competitor, who is hiring your former employee
 - Take steps to ensure employees do not breach obligations to former employers
 - Potential for an unclean-hands defense from the other side

Prelitigation Strategies and Procedures

- Should you send a demand letter to the employee (and employer) prior to initiating a lawsuit?
 - Pros:
 - *Negotiation before litigation may yield a less expensive resolution*
 - *It may be the first time the new employer learns of the restrictive covenant*
 - Cons:
 - *Gives the other side time to prepare its defense*
 - *If too much time, then may undermine immediacy of a TRO*

Prelitigation Strategies and Procedures

- Do you involve the new employer at the demand-letter stage?
 - Risks:
 - *Potential counterclaims*
 - *Tortious interference*
 - *Retaliation*

What Litigating a Noncompete Case Looks Like in Practice

Before You Lower Your Lance and Charge into Court

- What are your goals in pursuing litigation?
 - Total annihilation
 - Victory (flexible definition)
 - Message
 - Creative positioning
- Who will determine if goals are achieved?
 - Directly involved in the dispute?
 - How are they tied to the outcome?
- Do you have a story to tell beyond the fact that the employee signed the agreement?
 - Complex?
 - Compelling?
 - Persuasive? (Will there be significant life/money/company consequences?)



Before You Lower Your Lance and Charge Into Court

- Are you familiar with the local rules, laws, and judges?
 - “All politics is local!”
 - Judges are people too!
 - Laws, procedures, and outcomes may vary
 - Statute/case law
 - Blue penciling/red penciling
 - Assignment
 - Garden-leave clauses
- Can you afford to lose?
 - Money or trade secret
 - Public relations/customer(s)
 - Employee confidence (message)



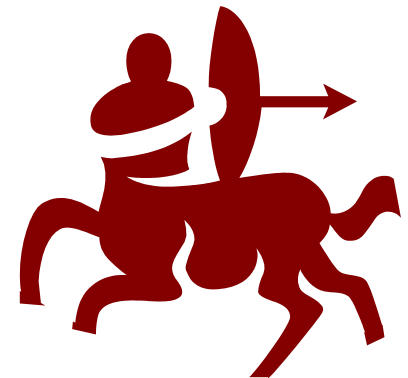
Before You Lower Your Lance and Charge Into Court

- Will third parties become involved?
 - Customer(s)
 - Regulator(s)
 - Competitor(s)
- Time Commitment?
 - Who from the company will be involved? (story, documents, investigation, history)
 - Preparation → hurry up and wait



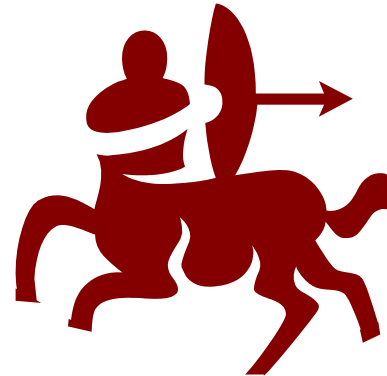
The First Wave of Arrows

- Theories of recovery
 - Breach of contract
 - Misappropriation of trade secrets
 - Breach of fiduciary obligations (good-faith fair dealing)
 - Conversion
 - Tortious interference with business relations
 - Inevitable disclosure
 - Damages



The First Wave of Arrows

- Defense/Counter Claims
 - Unclean hands
 - Defamation
 - Discrimination
 - Retaliation
 - Whistleblower claim
 - Contract (provision unenforceable)
 - *How do I count the ways?*
- Cease-and-desist letter



Battle

- Injunctions
 - Preliminary Injunction General Factors:
 - *Likelihood of irreparable harm (balance)*
 - *Plaintiff likely to succeed on merits*
 - *Public interest*
- Specific Performance and TROs
 - Irreparable harm \neq money damages
- The Details
 - Service of process
 - Bond requirements (What? When?)



Battle

- Discovery
 - Does not mean learning for the first time! Be as prepared as possible
 - Prefiling investigation is critical (litigation holds/electronic discovery)
 - Depositions – company witnesses, customers, others
 - Have key documents, witnesses, and compelling story ready (if for the plaintiff)
 - Have a solid story (if for the defendant)
- Hearing – hours → days → weeks → beyond?

Creative Resolution

- Remember: “Creative positioning goal”
- What do you really want? (Judge/Magistrate Judge)



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Considerations Regarding Hiring Employees With Noncompete Covenants

Considerations When Hiring a Competitor's Employee

- Should you ask if the employee has signed a restrictive covenant with his or her former employer?
 - Answer: Yes
 - Review is necessary to assess the potential for litigation and the likelihood of enforcement
 - Review is necessary to determine what, if any, modifications may be advisable with respect to the employee's job functions and responsibilities

Considerations When Hiring a Competitor's Employee

- Recommendations:
 - Do not just ask for the employee's "noncompete agreement"
 - Agreement could be buried in a stock option agreement or other document
 - Make sure you ask for the most recent version of the agreement that the employee signed
 - Request a signed copy of the agreement

Considerations When Hiring a Competitor's Employee

- What if the employee indicates that he or she cannot obtain the agreement without arousing suspicion of his or her current employer?
 - **Suggestions:**
 - *Ask again*
 - *Condition the offer on nonexistence of a restrictive covenant*
 - *Ask for current form agreement of employer*

Considerations When Hiring a Competitor's Employee

- Reviewing the agreement: what to look for
 - Is there a choice-of-law provision?
 - Is the choice-of-law provision enforceable?
 - Is there a venue provision?
 - Is the venue provision enforceable?

Considerations When Hiring a Competitor's Employee

In assessing enforceability, you may have to examine the laws of multiple states.

e.g.: A Texas employer wants to hire a Texas employee of a Mississippi employer. The employee has a noncompete with Mississippi venue and choice-of-law provisions.

Considerations When Hiring a Competitor's Employee

- When was the agreement executed, and does it matter?
- Is it a “mid-term” agreement or was it signed at the inception of employment?

Considerations When Hiring a Competitor's Employee

- Is there an issue with consideration under the law of the relevant state(s)?
 - Is at-will employment sufficient?
 - What about continued employment?
 - Does the agreement provide additional consideration?
 - Did the employee actually get the additional consideration?

Considerations When Hiring a Competitor's Employee

- Does the agreement specifically identify a legitimate business interest?
- Is the restriction narrowly tailored to protect that legitimate business interest?
- Does the new employer meet the definition of a “competitor?”
- Can the candidate adhere to the restrictions and perform in the new position?

Considerations When Hiring a Competitor's Employee

- Is the agreement overly broad with respect to time or geographic scope?
- Will the laws of the relevant state(s) allow reformation of the agreement?

If so...

Considerations When Hiring a Competitor's Employee

- What type of reformation is permitted?
- Are there any ramifications associated with reformation?
- Is the court likely to reform the agreement in a way that changes the outcome?

Considerations When Hiring a Competitor's Employee

- New Jersey: Overbroad covenant may be modified to delete prohibition that makes it overbroad and unreasonable. *Platinum Mgmt. v. Dahms*, 666 A.2d 1028 (N.J. Law Div. 1995)
- Texas: Reformation permissible but precludes damages for breach of the covenant that occurs prior to reformation. Tex. Bus. & Comm. Code § 15.51(c)

Considerations When Hiring a Competitor's Employee

- All clients, or just those with whom the employee conducted business?
- Does it matter under the relevant state(s) laws?
- Did the employee bring clients to the competitor employer from a previous job?
- Is there a geographic scope?

Considerations When Hiring a Competitor's Employee

- Other considerations:
 - What is the employer's past history of enforcement with respect to restrictive covenants?
 - Is the employee likely to bring over other employees?
 - Is the employee being hired because of his or her customer contacts or his or her "book of business"?

Considerations When Hiring a Competitor's Employee

- Should you include the employee in the legal analysis with respect to review of enforcement likelihood of the agreement?
 - No

Considerations When Hiring a Competitor's Employee

- Is it advisable to suggest that the candidate seek a waiver of particular restrictions?
 - Maybe in certain instances where enforcement is likely and the applicant may have some negotiation leverage

Considerations When Hiring a Competitor's Employee

- Agreements to indemnify the employee:
 - Preferable to avoid if possible
 - Likely to lead to company's being named in the lawsuit
 - Should be clear and limited to payment of attorneys' fees
 - Avoid commitment to pay employee during any period of time in which the employee is "on the bench" as a result of a court-ordered injunction

Considerations When Hiring a Competitor's Employee

- Other considerations:
 - Courtesy phone call to previous employee's counsel
 - Declaratory judgment

Considerations When Hiring a Competitor's Employee

- Advice to the departing employee:
 - Be candid and honest regarding subsequent employment opportunities
 - Avoid “trash talk” with former employer in email or other communications

Considerations When Hiring a Competitor's Employee

- Instruct applicant not to solicit coworkers or customers until after effective date of resignation
- Return all property at the time of termination
- Make sure no company information has been sent to personal email accounts or otherwise downloaded on thumb drives or other external devices
- Advise employee to return all paper documents

Considerations When Hiring a Competitor's Employee

- Offer letter or other preemployment correspondence
 - Should instruct potential employee not to bring, distribute, or use any confidential information of previous employer
 - Should confirm employee has reviewed duties and responsibilities associated with the position and that he or she can perform them without disclosing or using confidential information of previous employer

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