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LEGAL BRIEFS

A Primer on Restrictive Covenants

I. A High Tech Company's Sad Story

Consider this sad story:

Two entrepreneurs (call them Harry and Sally) open a computer consulting business in Columbia called hardsale.com, Inc. The business starts out at a good pace, so hardsale.com is able to hire two top-notch consultants, Larry and Curley, who proceed to cultivate a good working relationship with hardsale.com's clients. This frees up Harry and Sally to attend trade shows and play a lot of golf in an effort to market their business.

In time, Larry and Curley demand incentive bonuses and stock options, claiming that they are responsible for the tremendous growth of hardsale.com, Inc. Harry and Sally don't see things the same way, and Larry and Curley are shown the door.

Larry and Curley start their own computer consulting business next-door, their first order of business being to solicit all of hardsale.com's clients. They also manage to hire away two key hardsale.com employees. Larry and Curley took with them an intimate knowledge of hardsale.com's business plan, pricing policies and client lists, not to mention a fat Rolodex and a training manual that they had co-authored. Harry and Sally run screaming to their attorney, who advises them that there is not much they can do. Frustrated, Harry and Sally move to Key Marathon and start a charter-fishing service.

Sadly, this is an all too common scenario in the feeding frenzy competition of high-tech industry. Although not a new phenomenon in business, the risk of unfair competition from former employees is formidable in the high-tech world where talent and turnover are high.

Harry and Sally could have protected their interests by requiring their key employees to sign an employment agreement containing restrictive covenants.

II. Covenant Not to Compete

In a covenant not to compete, an employee typically agrees that he will not compete with his former employer for a stated period of time after termination of his employment. To be legally enforceable, the covenant must be reasonable in scope and duration. In most cases, the restriction will last two or three years and will be limited to a certain geographical area. A restriction will be considered reasonable to the extent the court finds that it is necessary to protect the employer's business, while not unduly depriving the employee of a livelihood. Courts view these restrictions critically, which has led to the myth that non-competition covenants are unenforceable. Properly drafted, however, they are quite enforceable and can be a powerful legal weapon against unfair competition.

To really have teeth, the covenant should expressly permit the employer to obtain a court order (known as an injunction) prohibiting the employee from violating the covenant. A lawsuit for monetary damages can drag on for years, whereas a temporary injunction can be imposed within a matter of days or weeks. Once the injunction is entered, the employee must discontinue the competitive activity throughout the duration of the suit. In addition to preventing the employee from raiding the business during this time, the injunction may also cut off the employee's financial support and, consequently, his ability to pay legal fees. The new employer may also be dragged into the suit, placing the employee's job security in jeopardy. These may be harsh tactics, but you may not think so when your business and livelihood are threatened.

III. Non-Solicitation Covenant

A non-solicitation covenant is far less restrictive than its first cousin, the non-competition covenant, in that it only prohibits the former employee from soliciting customers or from hiring away employees of the business. The employee remains free to compete with his former employer, provided he does not steal the employer's business in the process.



The non-solicitation covenant is also more likely to be legally enforceable because it does not prevent the employee from obtaining gainful employment. Perhaps more importantly, employees may be more likely to sign a non-solicitation covenant because it is less restrictive. A business-savvy computer consultant may refuse to sign the more onerous non-competition covenant.

Like the non-competition covenant, the non-solicitation covenant is enforceable by injunction.

IV. Non-Disclosure Agreements

The employment agreement should prohibit use or disclosure of the employer's proprietary information, including customer lists, financial records and computer software. The Maryland Uniform Trade Secret Act does provide some protection from misappropriation of trade secrets (i.e. information that is not generally known or readily accessible to the public). To be considered a "trade secret," however, the information must be subject to efforts by the employer to keep the information secret. In other words, the employer is more likely to enjoy trade secret protection if procedures are in place to protect the information, including labeling sensitive documents "confidential," locking information away after hours, securing computer data, and having employees sign a confidentiality agreement.

The Uniform Trade Secret Act allows enforcement by injunction, as well as recovery of attorneys' fees and punitive damages in certain cases.