

You Don't Know What You've Got 'Til It's Gone: Part 2: Agreements to Protect Your Intellectual Property and Human Capital

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ABOUT THIS WHITE PAPER:

Generally there are four types of employment agreements that companies may use to protect their interests when it comes to employees and independent contractors:

- **In non-compete agreements**, workers promise to avoid activities that would compete with the company—during or after their employment
- **Non-solicitation agreements** prevent workers from soliciting away customers or other employees
- **Confidentiality agreements** protect an employer's confidential information and trade secrets
- **Assignment of inventions** gives the company the right to most inventions or discoveries that employees or independent contractors make related to their employment

The rules for creating and enforcing these agreements vary from state to state. The agreements also need to be narrowly tailored to protect the employer and, to be enforced in court, must be backed up by company policies and actions. Taking these steps can protect your business from the theft or misuse of its competitive advantages, ideas, customers, and people.

The saying has become a cliché: “our employees are our most important asset.” If that’s really true, then you need to take a closer look at how you are protecting the information and relationships your employees have when they walk out the door each night—or leave your company for good!



More organizations are taking steps to protect these valuable assets. In 2010, 78.7 percent of every 1,000 CEOs in the U.S. had an employment contract. This was up from 72.5 percent in 2000.¹ But employment contracts aren't just for the C-suite. Your employees in IT, marketing, sales, and engineering, for example, also have access to proprietary information. And it's no surprise that from 2002 to 2012, there was a 61 percent rise in the number of former employees being sued for breach of contract.²

This paper covers four types of employment agreements to consider: non-compete agreements, non-solicitation agreements, confidentiality agreements, and assignment of inventions. It explains the purpose of each, how enforceable these agreements are, and what to keep in mind when creating them. (The first paper in this series examines your company's intellectual property: patents, trademarks, copyrights, and trade secrets. It can be found at <http://tinyurl.com/oq9auye>).

¹ “Litigation Over Noncompete Clauses is Rising” by Simon, Ruth and Loten, Angus. *The Wall Street Journal*, August 14, 2014. Viewed on February 7, 2014, at <http://online.wsj.com/news/articles/SB10001424127887323446404579011501388418552>

² Ibid.

What Is A Blue Pencil Provision?



Many states allow “blue penciling.” This means a judge may look at a non-compete agreement and decide that a particular provision is too broad or restrictive for an employee—but still meets the guidelines to be enforced in other areas. Then the judge will modify the agreement so it passes muster. States vary with respect to blue penciling, so it’s useful to have a lawyer who understands the precedents in this area.

What You Need To Know About Covenants Not To Compete

Not surprisingly, these are contractual agreements in which employees and independent contractors agree not to take certain actions that would compete with their employer. This could apply to the time a person is *with* a company or *after* employment—or both. From a legal standpoint, this agreement supplements what is covered under the common law duty of loyalty. We will spend more time discussing non-competes since many of the considerations at play are also relevant to the other types of agreements discussed in this white paper.

Enforcing Non-Competes

To be enforceable, the nature and scope of the restrictions placed on the employee can’t be greater than what’s needed to protect the company. In addition, the agreement can’t impose an undue hardship on the employee. It also can’t cause injury to the public.

If an employee doesn’t live up to his or her part of the covenant, then lawyers often get involved. This can take several forms. First, it could mean going to court on an emergency basis and obtaining an injunction against the employee, or new employer, to immediately stop his or her illegal conduct. Second, it could involve going to court on a non-emergency basis to seek other relief, such as money damages due to the breach. The third choice is stopping short of a court order and negotiating a resolution.

Ideas For Drafting

Unfortunately, there is no “one size fits all” approach when it comes to non-competes. It’s best to work with an attorney, to make sure your agreement meets enforceability requirements while adequately protecting the company. Here are important questions to consider:

Which State Law Will Apply?

Your lawyer can make recommendations on this point. For example, California, Virginia, and New Hampshire are among the most hostile jurisdictions for employers in typical non-compete cases. However, Florida and Georgia are generally more receptive to enforcing non-compete agreements.

You may want to consider including both a choice-of-law and venue provision in your employment agreement or employee handbook. A venue provision will allow you to select the state where any case involving the agreement would be heard. A choice-of-law provision allows you to select the state’s law that will apply to the agreement. Know, however, that the state where the services are being performed and/or where the employee lives or works will still have the most significant relationship to the agreement and may be the law applied. You can’t just pick a favorable state at random and expect a judge to uphold its laws.

However, most courts will enforce choice of law and venue provisions provided the chosen state has some relationship to the parties and the application of the chosen state’s law would not violate a fundamental public policy of a state with a materially greater interest in the dispute.

A Good Idea For Intake Interviews



When hiring someone, many companies think of the “intake meeting” as a way to begin the orientation process. Don’t forget to ask new people about any non-compete or similar agreements they had with their former employers. You don’t want to get embroiled in a case about violating a non-compete you knew nothing about.

What Considerations Are Needed?

When employees sign a non-compete, they are giving up something. Since you can’t expect to get something for nothing, you need to think about what to give them in return. This is what a court calls “consideration.”

Some non-competes are entered into when people join the company. This is a time when a number of aspects of employment are being negotiated. Make sure the conditions for the non-compete are addressed. Often, the promise of new employment or continued employment is sufficient consideration to support a non-compete. However, in some states, that may not be enough and you may want to consider providing something extra. For instance, a recent Illinois Appellate Court decision held that if employment is all that an employee receives as consideration for signing a restrictive covenant, and the employee does not remain with the company for at least two years, the restrictions are not valid.

Other times a non-compete may need to be signed after a person is already an employee. One example would be someone who has new responsibilities and is now privy to sensitive information or responsible for key client relationships. The employer needs to consider what the employee should get for signing a non-compete agreement, such as a promotion, a bonus, new benefits, a more flexible work schedule, additional vacation time, etc.

What Company Interests Need To Be Protected?

Companies must be specific in identifying just what they are trying to protect. For example, with a salesperson, an employer may want to protect a customer list. With a marketing professional, it could be the marketing plan. With an engineer, it might be the latest research or new product specifications. To properly draft the non-compete, your attorney needs to understand your business and what is at issue.

Courts will generally protect an employer’s interest, and enforce a non-compete or other similar restrictive covenant, in three broad scenarios:

- Employees have or had access to trade secrets or other confidential business information;
- Employees have or had access to the employer’s customers or confidential information regarding them; and
- Employees’ services are special, extraordinary or unique.

If you are not facing any of these situations with an employee, you might not need a non-compete agreement.

What Are The Time And Geographic Restrictions?

There are no set rules on these two factors. That means your attorney must understand the applicable state laws, your company’s unique situation, and how long any “competitive threat” would really last.

When it comes to time, courts generally will enforce up to two years for a non-compete. Three or four years will get more scrutiny. Five years is more likely to be seen as unenforceable. However, it really does all depend on the interest your company seeks to protect and the applicable state law.

For geographic restrictions, the agreement should only cover the area where trade secrets, confidential information or unique skills would affect your business or where customers are located or where the business is conducted. Be clear on whether or not this is regional or national. For instance, you may only need to bar a salesperson from competing in the region where she had sales responsibilities.

What If The Company Is Being Sold?

There are special considerations in this case, such as antitrust issues. However, non-compete agreements that are entered into as part of the sale of a business generally receive less scrutiny from the courts. In a sale of a business, there is usually more equal bargaining power so there is less need for the courts to intervene and alter the parties' agreement. Once again, an experienced attorney can help you sort through these issues.

What About Separation Agreements?

While not required, these are often used when an employee is not leaving by his or her choice. This type of agreement covers a number of areas: the facts behind the termination, any severance pay, the release of claims from either side, the employee's right to consult an attorney, confidentiality requirements regarding the terms, and boilerplate language about the applicable laws and enforceability of the agreement.

There are two key ideas here. First, you need to know that a separation agreement typically will supersede any earlier arrangements—including a non-compete. That leads to the second point: make sure that this agreement does not wipe out anything in an existing non-compete. A good practice is to reference and incorporate the terms of any prior non-compete. Additionally, if you didn't have a non-compete before, you may want to consider whether it would be appropriate to put one in place. However, this may require additional consideration above what is being given to secure the release. Again, an examination of state law is important to know whether any particular considerations may come into play.

What About Covenants Not To Hire?

These are particularly useful for service providers that do not want clients to hire their employees.

Courts focus on three questions in determining the enforceability of these agreements: 1) was the employee—or client—aware of this restriction; 2) how difficult it is to find a similar job; and 3) is there any restraint on trade.

What You Need To Know About Non-Solicitation Agreements

The goal with this type of agreement is to prevent a departing employee from contacting your *clients* and enticing them to join him or her at the new company. These agreements also can extend to preventing the same people from soliciting current *employees* at your company to come along as well.

Ideas For Drafting Yours

While there are obvious similarities between non-compete and non-solicitation agreements, it's best to keep them separate. That's because you usually can make non-solicitation agreements more restrictive than non-

competes. In general, courts will enforce non-solicitation agreements as long as the restrictions are reasonable to protect an employer's interest in its customers and employees.

Here are the questions to ask when creating these types of agreements:

Who Is The Employee?

This sounds simplistic, but take a closer look. Did the person actually have contact with customers or access to confidential information about them? Is the person in a position to take other employees with him or her—perhaps as head of a department? If neither of these is the case, then you may not need this kind of agreement.

Who Are The Customers?

What is key here is the employer's relationship with the clients. For example, Illinois courts require a "near permanent" relationship. When this is true, then the courts are more likely to enforce a non-solicitation agreement. They understand that it takes time to develop your clientele, and that you invest a certain amount of money to acquire customers—and this is worth respecting and protecting. Should you seek to enforce a non-solicitation agreement in the courts, you need to be able to explain the extent of contact your former employee had with one or more customers, as well as the importance of that client or those clients to your business.

What Are The Time And Geographic Restrictions Needed?

These vary by state. You may not even need a geographic restriction. Again, it's best to tailor the agreement to the interests your company really needs to protect. Bigger and broader isn't necessarily better, especially if you want the restrictions to hold up in court. For this reason, you may want to consider limiting the geographic scope to match where your customers are located.

The Benefits Of An Exit Interview



These interviews have long been considered a good way to learn important information, such as why someone is making a job change now. However, there are a number of reasons to have them with people covered by any employment agreements:

- It gives you the chance to remind them about the agreements they have signed and their associated responsibilities.
- You have the opportunity to discover where the person is going. If it is to a competitor, you may be able to watch for any violations of non-compete, non-solicitation, confidentiality, or assignment of invention agreements. When the employee is headed to a competitor, you may want to write to the new employer informing it of the restrictions.
- Ask the person to return all of the equipment or documents in his or her possession, to reduce the chances that intellectual property is being taken.
- In advance, you may wish to have your IT Department determine if any unusual electronic activities are or were going on—such as downloads or connections to devices.
- Have the person sign an acknowledgement of the obligations under any agreements and affirm that he or she has returned all company property. Having this will be very useful if you are forced to bring suit.

What You Need To Know About Confidentiality Agreements

Another common term for confidentiality agreements is non-disclosure agreements (NDAs). In general, they protect proprietary information about your company's products, services, operations, and customers. They may also cover trade secrets. However, this depends upon the state in which you are located and how it defines "trade secret."

What To Know When Drafting Yours

Not surprisingly, you need to specify that the employee—or independent contractor—signing the agreement has been or will be exposed to confidential information. It's very important to identify what kind of information this may be: a customer list, sales plans, etc. Unlike other agreements, you don't necessarily need to include time and geographic restrictions.

Many times we think "disclosing confidential information" is about sharing something with a competitor or the news media. Consider broadening that definition. This may mean including verbiage—and instituting a policy—that bars copying or transferring information to any computer, storage device or email account that the company doesn't own. Don't forget social media. You may want to have policies about what can be posted about the company on LinkedIn and Facebook pages, Twitter, or other social media sites.

It's also a good idea to have your employee sign an acknowledgement form during an exit interview, stating that he or she has returned all confidential information about the company.

Enforcing These Agreements

As you already surmised, these agreements must be considered reasonable to be enforceable. Here are the factors that courts generally consider:

- If enforcing the covenant will injure the public;
- If enforcement will cause undue hardship on the employee or independent contractor; and
- If the restraint placed on the person is greater than what's needed to protect the company.

If you intend to enforce an NDA, then your company must have strong policies on confidential information already in place. Courts won't extend protection to companies that haven't taken steps to keep their information secure. This makes it wise to implement these procedures:

- Have unique passwords;
- Keep confidential information under "lock and key"—whether this is an actual file cabinet or restricted electronic information only accessible to certain individuals or via a password;
- Ensure information and materials are returned before people leave; and
- Make certain that confidential information is only shared with those who need to know it. For instance, if you keep your key customer contact list generally available on the company's intranet, your claim for protection is certainly weaker than if that same list was restricted to password access by only certain employees.

What You Need To Know About Assignment of Invention Agreements

These agreements give the employer the rights to most inventions or discoveries made by an employee during the time he works there. The same applies for relationships with independent contractors. In addition, it may also prohibit either of these two groups from disclosing information about an invention or a project.

Some states have specific requirements for these agreements. For example, Illinois and California require that employees receive certain notices about invention assignments. Again, as with other agreements, it is best to consult with an attorney in drafting an assignment of invention to make sure that all state law requirements are met.

Depending on the type of employee or independent contractor, these types of agreements may not be necessary. However, if you hire an IT consultant to develop unique programming to fit your company's needs, you may want to consider an assignment of invention. The same is true for the engineer your company hires to develop a new product.

Protect Yourself

Most of your employees are likely to treat your company in an ethical way during and after their time with you. Unfortunately, there is the small percentage who will not. You need to protect your interests—and dissuade someone who may consider harming your company if an opportunity arose. One proven strategy is having the appropriate agreements in place.

As you have seen, however, it's not enough just to have people sign these pieces of paper. Your organization needs to have policies in place—such as ways to actively protect confidential information—to ensure these agreements are enforceable in court. In general, judges won't side with an employer who didn't secure confidential information and then complains that an employee misused it. And, courts won't support agreements that they believe unjustly favor the company to the detriment of the employee and the public.

Now is the time to address any vulnerability you have in this area. Your first step is to do an inventory of your agreements and policies, and to look for any deficiencies. It could be that you've been using a "one size fits all" template that doesn't really protect your company. Or, you have employees who should have but haven't signed a non-compete, non-solicitation, NDA or assignment of invention agreement—or several of these. Or, what's in your agreements is stricter than the policies you're enforcing. Then work with an experienced attorney to create agreements and policies that will hold up in court. The good news is these may be enough of a deterrent so that you never need to go there.

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