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Noncompete Agreement Litigation Strategies

Leveraging Trial Techniques, Identifying Causes of Action, Preparing for Defense Theories and Counterclaims

TUESDAY, JUNE 23, 2020

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Today's faculty features:

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Non-Compete Agreement Litigation Strategies

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Panel Overview

1. The Prevalence and Form of Non-Compete Agreements
2. Employer's Perspective: Drafting Enforceable Agreements
3. Employee's Initial Analysis: Non-Compete Agreement Pre-Litigation Concerns
4. Non-Compete Litigation: Preparing for Prosecution
5. Employee's Anticipation of Litigation
6. Non-Compete Litigation, Trial Tactics, and Settlement

The Prevalence and Form of Non-Compete Agreements

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The Rise of the Non-Compete

- "The growth of noncompete agreements is part of a broad shift in which companies assert ownership over work experience as well as work. A recent survey by economists including Evan Starr, a management professor at the University of Maryland, showed that about one in five employees was bound by a noncompete clause in 2014.Research indicates that one in four workers has signed a non-compete in their lifetime and 12.3 % are bound by one right now." Conor Dougherty, "How Noncompete Clauses Keep Workers Locked In," *The New York Times*, June 9, 2017.

- "They cover workers up and down the economic spectrum, from executives to hairdressers. . . . The growth of restrictive employement contracts dovetails with a broad pattern in the labor market: People don't quit their jobs as much as they used to." Conor Dougherty, "Noncompete Pacts, Under Siege, Find Haven in Idaho," *The New York Times*, July 14, 2017.

- "Non-competes are normally reserved for executives or at tech firms, to keep people from bringing trade secrets to another company. Lately, though, they've been popping up in more and more low-wage sectors too, like maids and nail stylists, prompting a spate of lawsuits" Lydia DePillis, "The rise of the non-compete agreement from tech workers to sandwich makers", *The Washington Post*, February 21, 2015; *see also* "Noncompete agreements snare low-wage workers," www.omaha.com, January 24, 2015.

Widespread Use

- Restrictive covenants are now utilized in companies big and small, new and old, across many industries.
- They are commonplace in financial institutions and the tech sector, particularly for more senior employees.
- They are also found in employment contracts in many small businesses and/or start-up companies, which want to ensure that their own know-how and customer relationships are protected.

Common Types of Restrictive Covenants

- **Non-Compete:** precludes the employee from competing with the employer and/or from working for a competitor of the employer, for some period of time after the employment has been terminated.

Examples – Jimmy John's Non-Compete

Employee covenants and agrees that, during his or her employment with the Employer and for a period of two (2) years after … he or she will not have any direct or indirect interest in or perform services for … any business which derives more than ten percent (10%) of its revenue from selling submarine, hero-type, deli-style, pita and/or wrapped or rolled sandwiches and which is located with three (3) miles of either [the Jimmy John's location in question] or any such other Jimmy John's Sandwich Shop.

http://www.huffingtonpost.com/2014/10/13/jimmy-johns-non-compete_n_5978180.html

Common Types of Restrictive Covenants

- **Non-Solicit (clients):** attempts to bar the employee from soliciting clients of the employer for some period of time following the termination of employment. These clauses may identify the clients at issue generally (*i.e.*, all clients the employee had contact with while employed) or specifically (*i.e.*, by name, although this is less common). They may also carve out certain classes of clients, such as those the employee knew before joining the employer. Some employers have attempted to impose even harsher provisions that prohibit doing business with certain clients, not just solicitation thereof, for some period of time.

- **Non-Poaching or No-Hire (employees):** attempts to bar the employee from soliciting other employees of the employer for some period of time following the termination of employment. Again, these clauses may be limited in a number of ways, including by the particulars of the employees at issue. Other variations include restraints on recruiting and hiring of certain employees.

Common Types of Restrictive Covenants

- **Confidentiality:** Employment contracts routinely contain confidentiality provisions that seek to limit the employee's use of trade secrets or other confidential information, during the period of employment and thereafter.
- Often, other restrictive covenants are viewed as an adjunct to confidentiality provisions—a concrete restriction to preclude a breach of another obligation that may be more difficult to enforce.

  (Note: The drafting of a confidentiality provision is not within the scope of this presentation, but itself raises a multitude of considerations.)

Variations

- An employment contract may contain a broad noncompete, along with clauses precluding the use of confidential information, and the solicitation of clients and employees.
- It may break up the clauses in the hope that, even if a court refuses to enforce a broad noncompete, it may enforce a more limited nonsolicitation provision.
- For various reasons, some contracts are limited to the more modest restraints against solicitation.

Garden Leave Provisions

- Some restrictive covenants operate by continuing to "employ" the individual – or at least to pay him or her – during the restrictive period.

- Very generally speaking, courts are more likely to enforce restrictive covenants where the employees are being compensated for them, in some shape or form.

Recent Trends

- Lots of skepticism about the use of non-competes with respect to relatively low-level employees.
- The Workforce Mobility Act – "A bill to prohibit certain non compete agreements, and for other purposes." Presented as "Bipartisan" By Sen. Chris Murphy (D. CT) and Sen. Todd Young (R. IN).
- From the Press Release: "An alarming 40 percent of American workers have been constrained by a non-compete agreement at some point in their careers. Non-competes often lack transparency and result in lower wages. Research indicates that workers trapped by non-competes are less mobile, which results in firms having difficulty hiring workers with the right set of skills. In states where non-competes are enforced, young firms are more likely to die in their first three years compared to states where they are not enforced."
- Follows the original bill in 2018, the MOVE Act in 2015 (attempting to ban non-competes for low-income earners).
- States action to ban for low-income workers (Maine, Maryland, Massachusetts, New Hampshire, Rhode Island, Washington) or imposing other restrictions.
- But still legal most places, especially for more highly compensated employees.
- Restrictions on use of non-competes against employees who have been terminated without cause. *See Buchanan Capital Markets LLC v. DeLucca,* Index No. 651913/16 (NY App. Div. Nov. 15, 2016).

Employer's Perspective:

Drafting Enforceable Non-Competes

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The Key Driver to Success: An Enforceable Agreement

- Follow the Pyramid Model
  - Base level of Confidential Information/Trade Secrets/ IP Assignment for all employees (with modifications as needed to comply with Section 7 of the NLRA and for R &D personnel)
  - Intermediate Level of Targeted Non-Solicitation Covenants where appropriate
  - Non-competes for targeted employees at the pyramidion

Drafting Enforceable Agreements

- Include offensive weapons in the contract:
  - Employee must disclose obligations to prospective employer
  - Employee agrees to divulge post-employment conduct
  - Employee consents to employer contacting any new employers to confirm compliance
  - Employee agrees to certify compliance upon request

Drafting Enforceable Agreements

- Preempt cloak and dagger departures
  - Invite employee to contact employer to discuss whether a new position will conflict with the agreement
- Consider extended notice of termination
- Scope the likely battlefield and consider arbitration
- Payment during the restricted period

In Term Considerations

- Polish Protectable Interests
- Implement and observe a sound Confidential Information and Trade Secrets protection program
  - Narrow trumps broad
  - Appropriate physical security controls
  - Appropriate electronic controls

- Customer Relationships
  - Address potential state law nuances, i.e. Illinois' requirement that the customer relationship must be "near permanent"
  - Impose appropriate security controls over marketing plans, customer visit reports, and business plans

“Blue Penciling”

- Know whether your jurisdiction permits blue penciling agreements.
  - Some jurisdictions, such as in DC and Maryland, allow courts to “blue pencil” or strike objectionable provisions from the restrictive covenant and enforce the remaining valid provisions.
  - Others, such as Pennsylvania, will modify an otherwise overbroad clause.
  - Finally, many jurisdictions prevent courts from revising or “bluepenciling” overly broad portions. The non-compete is either enforceable or it is not.

Choice Of Law and Forum

- When state law prohibits the use of a foreign law and adjudication in a foreign state
  - Prominent examples include California and Massachusetts
  - Delaware may no longer be a safe harbor for national employers
  - Impact of *NuVasive v Miles*

Drafting Non-US Agreements

- Be mindful of narrow duration and scope limitations—don't overreach
- Provide the minimum statutory compensation where required
- Don't Ignore IP ownership—employees may be entitled to compensation for creations
- When to forego the non-compete

Employee's Initial Analysis: Non-Compete Agreement Pre-Litigation Concerns

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Hypothetical

- Client works for employer with whom he signed post-employment restrictive covenant
  - Covenant includes a non-compete agreement
- Has received a job offer from a second employer
  - Working with the same government customer
  - Expanded duties
  - Different location
- Wants to know whether he can accept the offer and begin work for the new employer

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Hypothetical

- What is the process for advising the client?
  - Whether to accept the position
  - How/Whether to provide notice to subsequent employer

Existence of Agreement

- First establish that an agreement exists.
- Basic Contract Considerations:
  - Is there a writing?
  - Has there been an offer?
  - Has there been acceptance?
  - Adequate consideration?

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If Agreement Exists, What Defenses Are Available?

- Unenforceable provision?
- First Material Breach?
- Waiver or Estoppel?
- Unclean Hands?
- Economic Loss Doctrine or Source of Duty?
- Intracorporate Immunity Doctrine?
- Merely Planning to Compete in Future?

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If Agreement Exists, What Defenses Are Available?

- Generally speaking, there are three grounds for invalidating covenants not to compete:
  - **Unreasonableness**
    - Overbroad – greater than necessary; prevents indirect competition
      - Should be narrowly tailored; position, time, geography
    - Ambiguous – if vague, may create in terrorem effect
  - **Violates Public Policy**
    - Established state law, i.e., California, Montana, North Dakota, and Oklahoma
      - Partial non-compete restrictions, i.e., Maryland's Noncompete and Conflict of Interest Clauses Act (restricting employers from requiring workers earning less than $15 an hour or $31,200 a year from signing non-compete agreements).
    - Prevent public's right to choose profession
    - Key public player?
  - **Miscellaneous reasons in some jurisdictions**
    - Involuntary discharge
    - Assignment
    - No consideration

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3 Tiers of Enforcement

- Courts give strongest deference:
  - Dissemination of proprietary information
- Intermediate Deference:
  - Non-solicitation provisions.
- Least deference:
  - Pure non-competition agreements.
- Policy:
  - Promoting ability to work and support families

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Non-Compete Litigation:

Preparing for Prosecution

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Preparing to Prosecute—Two Track Approach

- Track one: Investigation-show and substance
- Ask questions before shooting
- The art of managing emotions
- Interview co-workers
- Evaluate electronic and paper footprints
- Attempt to interview the ex-employee and/or
- Request ex-employee to confirm he is not in breach
- Approaching the new employer

Preparing to Prosecute

- Track Two: Litigation preparation
- Prepare draft complaint and amend as needed
- Prepare witnesses and confirm availability
- Special considerations for customers
- Suppliers and Vendors
- Identify the strongest protectable interest
- Develop legal theories to align with protectable interest
- Retain expert witnesses as needed

Injunctive Relief

- Request must be explicit and focused
- Duration tied to elimination of business advantage
- Duration as a function of deterrence
- Duration measured by the “head-start”
- Bonding concerns

Defend Trade Secrets Act of 2016
18 U.S.C. § 1832 *et seq.* ("DTSA")

- Creates a federal civil cause of action against anyone who attempts to steal or misappropriate trade secrets. 18 U.S.C. § 1836(b)(1).
- Does not preempt state law and overlaps state versions of the Uniform Trade Secrets Act
- Includes a whistleblower protection provision for information provided to a government official or attorney for the purpose of reporting or investigating a violation.
- 3 year statute of limitations

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Defend Trade Secrets Act of 2016 18 U.S.C. § 1832 *et seq.* ("DTSA")

- Jurisdiction
  - Personal jurisdiction found: *Earthbound Corp. v. MiTek USA, Inc.*, 2016 WL 4418013, at *8 (W.D. Wash. Aug. 19, 2016).
  - Personal jurisdiction not found: *OOO Brunswick Rail Mgmt. v. Sultanov*, No. 2017 WL 264047, at *2 (N.D. Cal. Jan. 20, 2017)
- Remedies:
  - Injunctive relief
    - Types of injunctive relief: DTSA merely authorizes, but does not mandate injunctive relief and, thus, does not allow a presumption of irreparable harm—without showing irreparable harm, no injunctive relief. *See First W. Capital Mgmt. Co. v. Malamed, 874 F.3d 1136, 1143 (10th Cir. 2017)*
    - Expedited discovery: *Earthbound Corp. v. MiTek USA, Inc.*, 2016 WL 4418013, at *11 (W.D. Wash. Aug. 19, 2016)
  - Compensatory damages: actual loss, unjust enrichment, and royalties
  - Exemplary damages of not more than double compensatory award

DTSA Prima Facie Case

- Plaintiff must show that the defendant (1) misappropriated a (2) trade secret:

- (1) Misappropriation:
  - (A) acquisition of a trade secret of another by a person who knows or has reason to know the trade secret was acquired by improper means; or
  - (B) disclosure or use of a trade secret of another without express or implied consent

- (2) Trade Secret:
  - Includes business information if:
    - (A) the owner thereof has taken reasonable measures to keep such information secret; and
    - (B) the information derives independent economic value from not being generally known to, and not being readily ascertainable through proper means by, another person who can obtain economic value from the disclosure or use of the information.

  18 U.S.C.A. §§ 1839 (3, 5)

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Notable Decisions under the DTSA

- *Schein v. Cook*, 191 F. Supp. 3d 1072 (N.D. Cal. 2016),
  - First judicial decision under the DTSA
  - Judge granted a temporary restraining order prohibiting an ex-employee from soliciting plaintiff's customers.
  - Judge also granted an ex part seizure

- *Dalmatia Import Group, Inc. v. FoodMatch Inc. et al.*, 16-cv-02767 (E.D. Pa. Feb. 24, 2017).
  - First jury verdict under the DTSA
  - Awarded $2.5 million for misappropriation of trade secrets, trademark infringement, and counterfeiting.
  - Dalmatia alleged that FoodMatch stole its fig jam recipe, sold rejected jars of fig spread, and used Dalmatia's trademark without consent.
- DLMC, Inc. v. Flores et al., No. 18-00352 DKW-RT, 2019 WL 309754 (D. Haw. Jan. 23, 2019)
  - Court held that the asserted trade secret must be related to a product of service used in interstate commerce.
  - DLMC failed to show how a product or service related to the alleged trade secrets themselves—as opposed to DLMC's business in general—was used in interstate commerce

Employee's Anticipation of Litigation

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Employee's Current Posture

- Is current or former employer is aware of offer?
  - Many agreements require employee to give notice upon hire
- Relationship between prospective and former employer:
  - E.g., Is the prospective employer a competitor of the previous employer?
  - Is the prospective employer a client of the previous?

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Client's Goals and Concerns

- If agreement is enforceable, is client is willing to risk suit for breach?
- If not enforceable, concern about *in terrorem* threat
  - A notice from a former employer to a new one can be very harmful
  - This may not be something the employer is likely to do

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Anticipation of Cease & Desist

- Employee can inform the new employer of the non-compete agreement.
- Take a firm posture that the agreement is defective.
- Consider counterclaims:
  - Declaratory Judgment
  - Intentional Interference
  - Defamation
  - Wrongful Termination/Discrimination
  - Sexual Assault
  - Wage and Hour
  - Rescission

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Concerns About Being a Defendant

- Is client willing to negotiate an exit?
  - Limitations on scope of duties
  - Limitations on contact with certain customers
- Client may be litigation averse
  - Example: Security/intelligence community
  - SF-86 question 28:

Section 28 - Involvement in Non-Criminal Court Actions
In the last ten (10) years, have you been a party to any public record civil court action not listed elsewhere on this form?

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Declaratory Judgment

- Employee must decide whether to strike first.
- Disadvantage: some amount of litigation is guaranteed.
- Advantages:
  - Employee sets the factual playing field.
  - Employee can obtain injunction.
  - Likely, no damages have yet occurred.
  - Employee can control where action is filed.
    - Note: *Atlantic Marine* may limit this advantage

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Forum and Choice of Law

- Law varies greatly by jurisdiction
- Thus, venue and choice of law are critical
- *Atl. Marine Const. Co., Inc. v. U.S. Dist. Court for W. Dist. of Texas*, 571 U.S. 49 (2013)
  - Changes three aspects of a Court's § 1404(a) analysis:
    - "First, the plaintiff's choice of forum merits no weight." *Id*. at 581
    - "Second, a court evaluating a defendant's § 1404(a) motion to transfer based on a forum-selection clause should not consider arguments about the parties' private interests." *Id*. at 582.
    - "Third, when a party bound by a forum-selection clause flouts its contractual obligation and files suit in a different forum, a § 1404(a) transfer of venue will not carry with it the original venue's choice-of-law rules." *Id*.

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Non-Compete Litigation, Trial Tactics, and Settlement

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Enforcing Restrictive Covenants

Self Enforcement: Where severance or other payments are provided during the restrictive period, it is common to condition continued payments on compliance with the covenant, thus providing the employer with leverage to enforce the contract.

Court Enforcement: In other situations, employers seek the intervention of an appropriate court, suing for money damages, as well as injunctive and declaratory relief.

(The employment contract may specify the court, provide that the parties must arbitrate any dispute, or provide for some combination of court and arbitration proceedings.)

Decision to Seek Preliminary Relief

- Importance to business
  - Do you need to send a message? Is this the right message to send?
- Ability to retain business
  - Can the client relationship be saved? Can someone step in?
- Cost
- Likelihood of success
  - How bad if you lose? Is the case then over?
- Do you prefer actual damages or liquidated damages?
- Save it for later?

Preliminary Relief

- An employer may seek a preliminary injunction (and/or a temporary restraining order) to preclude the ex-employee from further breaching the restrictive covenant.
- Employer must demonstrate that the covenant at issue is valid and enforceable, and then it is in compliance with the employment contract.

  (There is authority holding, for example, that where an employer terminates the employee without cause, it may not then seek to enforce a restrictive covenant.)
- Employer must demonstrate that there has been a breach of contract by the ex-employee. Because the facts concerning the conduct of the ex-employee are not within the control of and may not even be known by the employer, proving a breach may be quite difficult.
- Employer must demonstrate that it is likely to suffer irreparable injury – *i.e.*, harm that cannot be adequately compensated by the payment of money (such as the loss of trade secrets and/or confidential information) – unless the employee is forced to stop breaching the covenant.
- Courts also consider the balance of hardship between the parties and the public interests.

Avoiding Preliminary Relief

- Control transition to avoid issues
- Agree to limited measures
- Attack irreparable injury
- Question validity of the covenant
- Wave the flag of the worker
- Public interest – how does it effect third parties (clients and others)

Attacks On Validity

Consider questioning the enforceability of a restrictive covenant where:

- The covenant is greater than needed to protect, is not intended to or does not in fact protect any legitimate interest of the employer;
- The covenant imposes undue hardship on the employee;
- The covenant is Injurious to the public;
- The employer will not want to risk an adverse decision invalidating man other agreements.

Common Defense Tactics

- Avoid Preliminary Relief
- Alternatively, Agree to Limited Preliminary Measures
- Counterclaims
- Fee Shifting
- Invasive Discovery
- Test the plaintiff's hiring practices and/or selective enforcement of non-competes.
- Delay
- More Delay

Trials

- Preliminary injunction proceedings may be decided on the law, but may require an evidentiary hearing where there are factual disputes.
- There are always factual disputes.
- A preliminary injunction hearing may be combined with trial on the merits, effectively creating a case that moves from commencement to trial on a very fast pace. *See* Fed. R. Civ. P. 65(a)(2).
- Some cases proceed to trial even after preliminary relief has been agreed to, imposed or denied.

Other Issues At Trial

- How clean are your hands?

  These cases are ultimately decided on the facts, and the conduct of the relevant parties is always of paramount importance.

- Witnesses – how good are yours?
- Witnesses – are you really going to call the clients to testify?
- Impact of publicity – is it worth it.

Settlement Considerations

- Potential tangible restrictions that can be agreed upon:
  - Nonsolicitation of employees and/or non hire agreement;
  - Definable geographic limitations;
  - Product limitations;
  - Customer limitations, by category, by location or by name;
  - Confidentiality;
  - Nondisparagement and fair play.
- And a little money never hurts.

Appendix

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Examples – Short Form Noncompete

- In consideration of Employee's employment, Employee agrees that while Employee is employed by [Company] and for a period of one (1) year following the termination of Employee's employment with [Company] for any reason or no reason (whether voluntary or Involuntary, with or without cause), Employee will not directly or indirectly: own, manage, operate, finance, join, control, or be connected as an officer, employee, consultant, agent, independent contractor, representative, trustee, partner, stockholder or other equity owner with, or render design, consulting, marketing, sales, management or operations advice or services to, or otherwise engage in, [describe business] or related business anywhere in the world, the geographic area serviced by [Company], in the capacity In which Employee or any subordinate of Employee was employed by [Company].

Example – Long Form Noncompete (p.1)

(a) Prohibited Conduct – During the period of your employment with the Company, and for a period ending twelve (12) months following a termination of your employment for any reason with the Company, you shall not, without the prior written consent of [Human Resources or Legal Department Designee]:

(1) personally engage in Competitive Activities (as defined below); or

(2) work for, own, manage, operate, control, or participate in the ownership, management, operation, or control of, or provide consulting or advisory services to, any person, partnership, firm, corporation, institution or other entity engaged in Competitive Activities, or any company or person affiliated with any person, partnership, firm, corporation, institution or other entity engaged in Competitive Activities; provided that your purchase or holding, for investment purposes, of securities of a publicly traded company shall not constitute “ownership” or “participation in the ownership” for purposes of this paragraph so long as your equity interest in any such company is less than a controlling interest.

Example – Long Form Noncompete (p.2)

This paragraph (a) shall not prohibit you from (i) being employed by, or providing services to, a consulting firm, provided that you do not personally engage in Competitive Activities or provide consulting or advisory services to any person, partnership, firm, corporation, institution or other entity engaged in Competitive Activities, or (ii) engaging in the practice of law as an in-house counsel, sole practitioner or as a partner in (or as an employee of or counsel to) a corporation or law firm in accordance with applicable legal and professional standards.

(b) Competitive Activities — For purposes of this Agreement, "Competitive Activities" means any activities relating to products or services of the same or similar type as the products or services (1) which were or are sold (or, pursuant to an existing business plan, will be sold) to paying customers of the Company, and (2) for which you have any direct or indirect responsibility or any involvement to plan, develop, manage, market, sell, oversee, support, implement or perform, or had any such responsibility or involvement within your most recent 24 months of employment with the Company. Notwithstanding the previous sentence, an activity shall not be treated as a Competitive Activity if the geographic marketing area of such same or similar products or services does not overlap with the geographic marketing area for the applicable products and services of the Company.

Examples – Short Form Nonsolicit

- I will not solicit any customer of [Company] for any business purpose, solicit or persuade any employee of [Company] to leave its employ, or disclose any confidential information of [Company].

Examples – Long Form Nonsolicit

- In consideration of Employee's employment, Employee agrees that while Employee is employed by [Company] and for a period of one (1) year following the termination of Employee's employment with [Company] for any reason or no reason (whether voluntary or Involuntary, with or without cause), Employee will not directly or indirectly:

  (a) solicit (or assist in soliciting), directly or indirectly, for the performance of business or services, interfere with or attempt to entice away from [Company] or any of its affiliates, or accept such business from any person or entity: (i) which is at the time of such solicitation, or was within twelve (12) months prior to such solicitation, a client or prospective client of [Company] or any of [Company's] affiliates of whom Employee obtained Confidential Information, or (ii) with whom Employee has (or had) personal contact or dealings on behalf of [Company] at any time during the twelve (12) months immediately preceding the date of Employee's termination; or (iii) with whom employees reporting to Employee have had dealings on behalf of [Company] or any affiliate of [Company] at any time during the twelve (12) months immediately preceding the date of termination; or (iv) for whom Employee was directly or indirectly responsible at any time during the twelve (12) months immediately preceding the date of termination; or

  (b) solicit (or assist In soliciting), directly or indirectly, for employment, employ, interfere with or attempt to entice away from [Company] or any of [Company's] affiliates any person who is an employee, consultant or agent of [Company] or any of [Company's] affiliates, who Employee came into contact with during employment, learned about during employment or obtained knowledge of such person's skills and abilities during employment with [Company]; or solicit (or assist in soliciting), directly or indirectly, any supplier or licensee of [Company] with whom Employee or Employee's subordinates or designees had contact or obtained confidential information regarding during employment with [Company].