

COVENANTS NOT TO COMPETE

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Many bosses love covenants not to compete. Usually they come in a two page document, but the most important part looks something like this:

Executive agrees that he has learned Company trade secrets and confidential information as a part of his employment. Within 3 years after his employment with the company terminates: (i) Executive will not solicit any current or pending customer or client of the Company to do business with a direct or indirect competitor of the Company; (ii) Executive agrees that he will not, for three years after his employment with the Company terminates, work for, own, direct, manage, operate, or control any business which competes directly or indirectly with the Company in any of the lines of business described above [sometimes it says “within 30 miles]; (iii) Executive will not assist others in engaging in any competitive business; (iv) Executive will not induce employees of the Company to terminate their employment with the company or hire any employees of the Company to work with Executive or any company or business affiliated with Executive.

Bosses see very little down side in agreements like this.

Human Resource Managers learn to say two very different things about covenants not to compete. To bosses they say, “You can’t always enforce a covenant not to compete. They are enforced to protect trade secrets, but many companies use them simply to scare employees.” To employees they say, “We are really tough on covenants not to compete. The boss expects everybody to abide by them”. Keeping both stories straight can be exhausting. Is there a simpler answer?

According to Maryland’s highest court, here is the “general rule”.

“A [covenant not to compete] will be [enforced] if the restraint is confined within limits which are no wider as to area and duration than are reasonably necessary for the protection of the business of the employer and do not impose undue hardship on the employee or disregard the interests of the public.” *Holloway v Faw*, 319 Md. 324 (1990).

The phrase, “necessary for the protection of the business of the employer” generally means necessary to protect trade secrets. Former employees are allowed to compete with

their former employers. Courts see such competition as healthy. On the other hand, “trade secrets” are property. Former employees are not entitled to steal or misuse them. An employer can often get an injunction (and order to stop doing something) to prevent a former employee from misusing trade secrets.

Employers call their lawyers most often about sales people and people with technical information. There are many variations on this theme, but if you understand these two job types, you can analyze variations.

Sales People

The most frequent lawyer call goes something like this. “Larry Salesman just quit to go to work for our number one competitor. Larry knows all our key customers, and what they buy. He is very familiar with pricing. Now he is going to steal our customers. We have a non-compete. You have to stop him.” In this type of case, the questions are;

- Are customer identities or preferences trade secrets?
- Is the former employee actually trying to steal customers? (To find out if the former employee is stealing customers, the employer may have to ask customers what is going on.)

Customers you can find in the phone book or non-repeat customers who answer ads are not trade secrets. On the other hand, customers located by word of mouth or customers who order monthly for years can be trade secrets if the employer takes reasonable steps to keep them confidential.

Whether the sales people in your company have confidential customer information is something you can figure out even before anyone quits. If your sales people call on the same prospects numerous times to make sales, the customers are probably trade secret. To help prepare your case in advance, you should tell everyone with access to customer information that it is confidential.

Technical People

Maryland has a statute called the “Maryland Uniform Trade Secrets Act”. The Act makes it illegal to “misappropriate” a trade secret and permits injunctive relief, damages, and in some cases, attorneys fees. A “Trade Secret” is information, including a formula, pattern, compilation, program, device, method, technique, or process, that:

- Is valuable because it is not generally known **and**;
- Is reasonably protected by the employer.

Employers have called the following “information” trade secret; business plans, accounting methods, cost data, machine set up information, truck routing information, and the formula for Coca-Cola.

If a former employee signed a covenant not to compete, his possession of a trade secret may be enough to have that covenant enforced. In *Lejeune v Coin Acceptors*, 381 Md. 288 (2003), Maryland's highest court considered the "inevitable disclosure" doctrine. Under that doctrine, an employee can be enjoined from working for a competitor if he would inevitably disclose trade secrets. For example, B.F. Goodrich was the first space suit manufacturer. B.F. Goodrich successfully enjoined an employee from working for a new space suit manufacturer because he would inevitably disclose how B.F. Goodrich made space suits.

In *Lejeune*, the employer **did not** have a covenant not to compete. The Court said, "Maryland has a policy in favor of employee mobility" and refused to apply the "inevitable disclosure" doctrine. The Court went on to say, however, that the result might have been different **if there was a covenant not to compete**.

The major problem in most "technical people" non-compete cases is proving a trade secret. If an employer claims a lemonade formula is secret, you must prove the formula is not on the internet. The key first question is always, "What is the trade secret?" It is not enough to say, "Our process is secret?" The employer must identify some part of the process that is not commonly known in the industry.

Conclusion

Covenants not to compete often, but not always, create enforceable rights for employers. Employers must show that the non-compete is reasonable, and that the employer has a business interest to protect. Just keeping good employees is not enough interest. If an employer can state specifically what trade secrets it is protecting, there is a good likelihood a court will protect those secrets.