EIGHT TIPS FOR EMPLOYERS ON NON-COMPETE AGREEMENTS©

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1. Analyze the need for a non-compete; I would specifically recommend using a non-solicit rather than a non-compete to reduce the number of things that are analyzed for reasonableness (non-solicitation agreements also are considered less of a restriction on competition and therefore more reasonably tailored to protect an employer's interests).

In *Bennett v. Storz Broadcasting Co.*, 270 Minn. 525, 534 (1965), the Minnesota Supreme Court set forth the test to be used to determine the reasonableness of a non-compete provision. A restrictive covenant must be "necessary for the protection of the business or good will of the employer" and must not impose "upon the employee any greater restraint than is reasonably necessary to protect the employer's business." *Id.* In addition, the restrictions cannot be overbroad in geography, time, or scope. *Id.*

Therefore, the first step in drafting is to determine what the employer is attempting to guard against and then to tailor the contractual provisions as narrowly as possible to meet that objective. One way to narrow the focus is to limit the agreement to preventing solicitation of current customers or clients of the employer for a set period of time. Non-solicitation provisions are often held to be reasonable because they impose less of a restriction on competition. *See, e.g., Cherne Industrial, Inc. v. Grounds & Associates, Inc.*, 278 N.W.2d 81, 88, n.2 (Minn. 1979) (where defendant was free to solicit business from others with whom plaintiff did not do business, the restraint was reasonable); *Webb Publ'g Co. v. Fosshage*, 426 N.W.2d 445, 450 (Minn. App. 1988) (upholding non-solicitation restriction). Depending on the nature of the business, this type of restriction may be sufficient to protect the employer's interest.

2. As a corollary to #1 above, consider whether an agreement is needed when trying to protect trade secrets and make sure that any agreement used identifies what information is being protected and why (keeping in mind that the Uniform Trade Secrets Act protects such information regardless of the existence of an agreement—assuming there are actual trade secrets as opposed to confidential information).

Determine what information the employer is trying to protect: does it qualify as a trade secret as defined by the Minnesota Uniform Trade Secrets Act, or is it confidential information that may not rise to the level of a trade secret but still merits protection?

The Minnesota Uniform Trade Secret Act (MUTSA) protects certain types of information by providing for a separate cause of action for misappropriation of trade secrets. Minn.Stat. § 325C.01; *Electro-Craft Corp. v. Controlled Motion, Inc.,* 332 N.W.2d 890, 897 (Minn. 1983). Under the MUTSA a trade secret is defined as "information, including a formula, pattern, compilation, program, device, method, technique, or process" that meets the following criteria: (1) the information must be neither generally known nor readily ascertainable; (2) the information must

derive independent economic value from secrecy; and (3) the plaintiff must make reasonable efforts to maintain secrecy. Minn.Stat. § 325C.01, subd. 5.; *see also Electro-Craft,* 332 N.W.2d at 899.

If the information to be protected does not fit squarely with the MUTSA it should be specifically identified and described in the agreement. Courts have generally held that customer lists, business information and the like are not trade secrets as defined by the MUTSA. *See Reliastar Life Ins. Co. v. KMG America Corp.*, 2006 WL 2529760 *4 (Minn. Ct. App. September 5, 2006) ("Customer lists are generally not deemed trade secrets or confidential. But customer lists and information that meet the elements of the UTSA will receive protection.") (*citing Blackburn, Nickels & Smith, Inc. v. Erickson,* 366 N.W.2d 640, 645 (Minn.App.1985); *Cherne*, 278 N.W.2d at 89)). However, "confidential business information which does not rise to the level of a trade secret can be protected by a properly drawn covenant not to compete." *Modern Controls v. Andreadakis*, 578 F.2d 1264, 1268 (8th Cir. 1978); *Bennett*, 270 Minn. 525); *see also Cherne,* 278 N .W.2d 81 (finding that a list of customers amounted to confidential information and affirming injunction prohibiting use by former employee).

3. As a corollary to #2 above, have annual acknowledgments executed by employees demonstrating the existence of such agreements and the protected nature of client information and/or business information.

Employees who have access to trade secrets or confidential information should be required to acknowledge their confidentiality obligations on an annual basis. Not only does this remind the employee that he or she is, in fact, subject to nondisclosure and/or non-piracy obligations, it provides another layer of protection for the employer. Four criteria are used by courts to determine whether alleged confidential or proprietary information is in fact "confidential": (1) the protected matter is not generally known or readily ascertainable, (2) it provides a demonstrable competitive advantage, (3) it was gained at expense to the employer, and (4) it is such that the employer intended to keep it confidential. *Cherne*, 278 N.W.2d at 90.

Based on these factors, it is crucial for employers to take steps to protect information that is the subject of a nondisclosure agreement. Requiring employees to regularly acknowledge their nondisclosure obligations and agreements helps bolster the employer's argument that the information is confidential and its contractual protections are valid and enforceable.

4. Consideration, consideration, consideration is the name of the game.

To be valid, a non-compete or non-solicit agreement must be narrowly tailored and, like any other contract, must be supported by valid and enforceable consideration. Failure of consideration is therefore one clear avenue for attack by an employee defending against an enforcement lawsuit. More often than not, a non-compete is entered into at the outset of the employment relationship; however, that is not always the case, particularly with employees who move up the ranks from an entry level position to one in which they have access to trade secrets or confidential information such as customer lists. In such situations it is important to determine whether additional consideration is needed.

Restrictive covenants entered into as a condition of employment do not require additional

consideration. *See Modern Controls v. Andreadakis*, 578 F.2d 1264 (8th Cir. 1978). However, restrictive covenants that are not incident to initial employment must be supported by independent consideration. *See National Recruiters, Inc. v. Cashman,* 323 N.W. 2d 736, 740 (Minn.1982); *see also Freeman v. Duluth Clinic, Inc.*, 334 N.W.2d 626, 630 (Minn.1983). Continued employment can not provide consideration for an agreement entered into after employment has begun unless it is supported by independent consideration. *See Freeman,* 334 N.W.2d 626; *see also National Recruiters,* 323 N.W. 2d at 740.

This does not necessarily mean that a non-compete must be signed contemporaneously with the commencement of employment. As long as the restrictive covenant is "ancillary to employment" it will be valid without additional consideration. *Modern Controls,* 578 F.2d at 1267. For example, in *Tonna Heating Cooling, Inc. v. Waraxa*, 2002 WL 31687601 (Minn. App. 2002) (unpub. op.), the Minnesota Court of Appeals upheld a preliminary injunction where the employee did not see or sign the non-compete document until long after commencing employment. The Court held that because the employer told the employee during the interview that a non-compete agreement would be required, the non-compete was "ancillary to the offer of employment" and, thus, supported by consideration. *Id.* at *4; *see also Basiccomputer Corp. v. Scott*, 973 F.2d 507, 511 (6th Cir. 1992) (non-competes signed after employees began work were enforceable because employees knew before beginning work that they would have to sign non-competes).

The adequacy of consideration for a non-compete in an ongoing relationship depends on the facts of each case. *See Davies & Davies Agency, Inc. v. Davies,* 298 N.W.2d 127, 130 (Minn.1980)). "The mere continuation of employment can be used to uphold coercive agreements, but the covenant must be bargained for and provide the employee with real advantages." *Freeman,* 334 N.W.2d at 630 (agreement lacked consideration where employee received no benefit as a result of signing and no distinction was made between signers and non-signers); *see also Jostens, Inc. v. National Computer Sys., Inc.,* 318 N.W.2d 691, 703-04 (Minn.1982) (holding that noncompete agreements lacked consideration because employer did not provide employees with future benefits, raises, or promotions); *cf. Davies & Davies Agency, Inc. v. Davies*, 298 N.W.2d 127, 131 (Minn. 1980) (adequate consideration found where agreement provided "substantial economic and professional benefits").

5. Know the state or law that will govern your agreement and have it explicitly identified in the contract (a corollary being that you will know whether the "blue pencil doctrine" applies).

Include both forum selection and choice of law provisions and make sure the agreement is tailored to the requirements of the law under which it will be interpreted. Parties to a contract "acting in good faith and without an intent to evade the law, may agree that the law of either state shall govern." *Combined Insurance Co. of America v. Bode*, 247 Minn. 458, 463-64, 77 N.W.2d 533, 536 (1956).

Minnesota follows the blue pencil doctrine, which permits the court to modify, or "blue-pencil," any term make it reasonable. *See e.g. Satellite Ind., Inc. v. Keeling*, 396 N.W.2d 635, 640 (Minn. Ct. App. 1986); *Klick v. Crosstown St. Bank*, 372 N.W.2d 85, 88 (Minn. Ct. App. 1985); *see also Roth v. Gamble-Skogmo, Inc.*, 532 F. Supp. 1029, 1031 (D. Minn. 1982). However, not all states utilize the blue pencil doctrine. *See e.g. Roto-Die Co., Inc. v. Lesser*, 899 F.Supp. 1515, 1523 (W.D.Va. 1995) (Virginia courts have never adopted the blue pencil doctrine); *CAE Vanguard, Inc. v. Newman*, 246

Neb. 334, 518 N.W.2d 652, 655-6 (Neb. 1994) (declining to adopt the blue pencil doctrine). For example, in Wisconsin if one portion of an agreement is unenforceable, the entire agreement may be deemed unenforceable. *See e.g. General Medical Corp. v. Kobs*, 507 N.W.2d 381, 385 (Wis. Ct. App. 1993).

In addition, in a number of states the enforceability of non-competes and non-solicits is governed by statute. *See e.g.* S.D. Codified Laws § 53-9-11; Wis. Stat. Ann. § 103.465; Nev. Rev. Stat. §613.200; N.D. Cent. Code §9-08-06 (covenants not to compete between employers and employees are void).

6. Insist on separate review by the employee's counsel when initially entering into an agreement and if no review is done, have a separate document verifying the employee's knowing waiver of review by counsel. Also, clearly identify that the compensation contract that serves as the initial consideration for the agreement is a separate and independent contract that can be altered or changed by the employer as it sees fit.

This is directly related to the consideration issues already discussed. All restrictive covenants should be fully negotiated at the inception of the agreement. Having the agreement reviewed by counsel helps ensure that it was bargained for—not imposed—and will be fully enforceable. Furthermore, suggesting that the agreement be reviewed by an attorney helps impress upon the employee the significance of the agreement and the fact that it will be fully enforced should it become necessary.

Also related to the consideration issue, it should be made very clear in the agreement itself that any attached compensation package, bonus structure or commission schedule is a separate and independent document. While employment may serve as consideration for the non-compete, the specific terms of compensation should remain modifiable by the employer without disrupting any restrictive covenants. To further this objective, the non-compete agreement should include a severability clause. *See Guerico v. Production Automation Corp.*, 664 N.W. 2d 379, 385 (Minn. Ct. App. 2003) (agreement without a severability clause was to be interpreted as a whole; document provided no evidence that the commissions clause and the non-compete clause were to be interpreted separately).

7. Do an annual inventory and check up to make sure that every employee that should have an agreement does, and that #4, #5, and #6 above are also satisfied (the corollary here being that there should be a protocol in place and a central location and or entity that will help counsel understand and assemble the facts when moving for injunctive relief).

Employers should review all their employees' non-compete, non-solicitation and non-disclosure agreements regularly to make sure they are as they should be. Confirm that the employer has an agreement in its possession for every employee who should have an agreement. Preferably the agreement should be maintained with the employees personnel file. If the employee has had more then one agreement over the course of his or here employment, all of them should be in the file.

Confirm that the employer and employee are abiding by all the terms of the agreement as it is written. This is particularly crucial for businesses that have merged with or acquired other business and for industries in which compensation structure or other terms of employment may change over the course of an employee's tenure. If there is a discrepancy between the written agreement and actual practice, take some time to review the situation (ideally with an attorney) before making any changes—this is true even if the employer's goal is merely to revert back to the written terms of the agreement.

Determine whether the agreement was reviewed by counsel for the employee, and if so, whether there is any indication of that in the file.

Confirm that the agreement still meets the employer's needs. If it is out of date or otherwise out of touch with the realities of the business or industry, consider modifying or amending it.

Finally, put a protocol in place so that if the employer needs to seek injunctive relief, counsel will be able to quickly obtain the essential information. All documents evidencing an employee's history with the company should be maintained in one central location or by one person or entity.

8. Be prepared and willing to spend money to enforce and protect your rights (with a corollary being that there should be a fee award provision that is one-way and favors the employer only in enforcing those rights).

Enforcing a non-compete or non-solicit agreement can be very expensive. The employer will be forced to spend a significant amount of money to enforce its rights and protect its business. A professional split is akin to a divorce in many respects. The litigation is often highly contentious and the participants—including their attorneys—may become more emotionally involved than in a typical commercial lawsuit. A substantial amount of discovery will likely be required before settlement becomes a realistic option. In addition, enforcing a non-compete will most likely require a considerable time-expenditure by other company employees who will need to assist in building the case by gathering information for written discovery, attending depositions and the like. The added "hidden cost" of employee time is not recoverable. Employers should consider including a one-sided fee award provision, granting fees only to the prevailing employer but not to a prevailing employee.

Bonus tip: Never, ever, be discouraged if the request for a TRO is denied and seriously consider whether you want to make such a request or simply litigate. The notion here being that if the employee is successful in avoiding injunctive relief the employee and his or her counsel may feel emboldened and settlement or resolution short of trial may actually be more difficult.

The decision to seek injunctive relief is often made hastily and, by necessity, is often made without all the facts and information needed to asses the case. As discussed above, these types of disputes can become very heated. That emotion or indignation can get in the way of the real objective, and may impede information gathering. Decide whether one more day, or one more week, will really make a difference. Building a clear picture of the facts is crucial, particularly if there is a complicated history.