Negotiating Out of Restrictive Covenants

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Negotiating restrictive covenants has become an essential part of practicing employment law as companies aggressively move, in a still faltering employment market, to restrict their employees' rights to compete in the workplace. Whether employees are bound by a confidentiality agreement, restricted from working in a particular industry or prevented from bringing clients with them in a career move, these restrictions impose "real life" as well as legal consequences.

In negotiating these agreements, employee's counsel must consider the relevant facts and law. Analysis of New York law, both common and case law, and the criteria for enforcement are critical to any effective negotiation. Just as important is knowing your client's needs when employment ends and understanding the employer's goals in imposing these restrictions.

I. Common Restrictive Covenants

Restrictive covenants in the employment context are agreements between employers and employees that prohibit employees from competing in the same or similar industry and geographic market as the employer (non-compete provisions), sharing information outside of employment (confidentiality provisions) and "raiding" clients/customers and other employees of the former employer (non-solicitation provisions) after employment ends. In most states, these restrictions must be voluntary, reasonable and of specific duration in time and geography.[1] To be

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[1] Columbia Rubber v. A-1-A Corp., 42 N.Y.2d 496, 499, 398 N.Y.S.2d 1004 (1977). For a sample New York cases discussing restrictive covenants, see: Johnson Controls, Inc. 04 Civ. 4095, 2004 US Dist. LEXIS 11709, *22 (S.D.N.Y. June 24, 2004); Battenkill Veterinary Equine P.C., 1 A.D.3d at 858, 768 N.Y.S.2d at 506; Mallory Factor, Inc. v. Schwartz, 146 A.D.2d 465, 536 N.Y.S.2d 752 (1st Dept. 1989); Rochester Telephone Mobile Communications, Inc. v. Auto Sound Systems, Inc., 182 A.D.2d 1119, 583 N.Y.S.2d 92 (4th Dept. 1992); Anametrics Services Inc. v. Botway, Inc., 159 A.D.2d 247, 552 N.Y.S.2d 238 (1st Dept. 1990); Budoff v. Jenkins, 143 A.D.2d 250, 532 N.Y.S.2d 149 (2nd Dept. 1988), mot. for leave to app. denied, 73 N.Y.2d 810 (1988); Novendstern v. Mt. Kisco Medical Group, 177 A.D.2d 623, 576 N.Y.S.2d 329 (2nd Dept. 1991), mot.. for leave to app. dismissed, 80 N.Y.2d 826 (1992); Quandt's Wholesale Distributors, inc. v. Giardino, 87 A.D.2d 684, 448 N.Y.S.2d 809 (3rd Dept. 1982); Weintraub v. Schwartz, 131 A.D.2d 663, 516 N.Y.S.2d 946 (2nd Dept. 1987).

reasonable, the restriction should be no greater than required "to protect the employer's legitimate business interests."[2] Historically, these restrictions were primarily reserved for the unique or highly talented employee or senior executive. However, in the current economic climate, where unemployment remains a factor and employers have the upper hand, restrictive covenants are frequently imposed upon mid-level managers and even rank-and-file employees.

Many companies include several different provisions in a single document often handed to new employees as part of an orientation packet. Employees may be asked to sign this document without being advised of its legal ramifications or given the opportunity to consult an attorney. Alternatively, the document may be presented at the end of employment as a component of a severance agreement. If the terminated employee does not sign the release and agree to the terms of the covenants, he may be denied enhanced benefits upon departure. Often, employees are asked to reconfirm restrictions agreed to years earlier when employment began. Once signed, these restrictions are binding and may affect an employee's future chance for employment.

II. New York Courts & Enforcement

Although generally disfavored by New York State courts, restrictive covenants will be enforced if reasonable and limited in duration and geography, and entered into voluntarily and knowingly, especially where a high-level employee or her attorney was involved in the negotiating process.[3] In determining enforcement, a court balances the employer's business interests against the employee's ability to earn a living.[4] Moreover, courts will enforce such restrictions only to the extent necessary to protect the employer from any unfair advantage arising from the employee's use or disclosure of confidential information or trade secrets. New York courts will "blue pencil" an agreement to remove provisions that are unenforceable but leave provisions that are.[5]

Whether or not an employee signs a confidentiality provision, a court may still find disclosure of confidential information actionable under common law. New York courts have held that specific

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[2] BDO Seidman v. Hirshberg, 93 N.Y.2d 382, 389, 690 N.Y.S.2d 854, 857 (1999).
[3] Ticor Title Ins. Co. v. Cohen, 173 F.3d 63, 66-68 (2nd Cir. 1999).
[4] Columbia Ribbon, 42 N.Y.2d at 499, 398 N.Y.S.2d 1004 (October 18, 1977); Rifkinson-Mann v. Kasoff, 226 A.D.2d 517, 641 N.Y.S.2d 102 (2nd Dept. 1996).
[5] BDO Seidman, 93 N.Y.2d at 394, 690 N.Y.S.2d at 859.

marketing plans and price information, customer preferences, customer-specific pricing data and financial information to be confidential and/or trade secrets.[6] On the other hand, customer lists that can be obtained from the telephone book or other public sources, or remembered information as to the business needs of customers, the intricacies of business operations, and mere knowledge of the employer's business, are fair game.[7] Customer lists have been held confidential when there is a detailed description of the customers and the names on the list were not readily available from a source outside of the employer.[8]

Non-solicitation clauses prohibit the solicitation of clients and/or customers, as well as the recruitment of co-workers from the former employer. Unlike non-compete clauses, non-solicitation provisions are generally enforced by New York courts, provided they are reasonable and do not prevent an employee from obtaining new employment in his profession.

Enforcement of a non-compete will ultimately turn on the risk of harm to a former employer and evidence of a protected interest that outweighs the employee's need to earn a living.[9] Most non-competes are difficult to enforce if the period of non-competition extends for more than one year in duration and exceeds a geographic location that is reasonable in a given marketplace. The uniqueness of the position and the industry itself may often determine whether the non-compete will be enforced and for how long.[10]

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[6] Earthweb, Inc. v. Schlack, 71 F.Supp.2d 299, 314 (S.D.N.Y. 1999), remanded, No. 99-9302, 2000 U.S. App. LEXIS 1245 (2nd Cir. 2000); FMC Corp. v. Taiwan Tainan Giant Indus. Co., Ltd., 730 F.2d 61, 63 (2nd Cir. 1984); Unisource Worldwide, Inc. v. Valenti, 196 F.Supp.2d 239, 278; Alside Div. Of Associated Materials Inc. v. LeClair, Index No. 6495-01, RJI No. 0101068001 (N.Y. Sup. Ct., Jan. 18, 2002), aff'd, 295 A.D.2d 873, 743 N.Y.S.2d 898 (3rd Dept. 2002).

[7] Briskin v. All Seasons Servs., 206 A.D.2d 906, 615 N.Y.S.2d 166 (4th Dept. 1995); Data Sys. Computer Centre v. Tempesta, 171 A.D.2d 724, 566 N.Y.S.2d 955 (2nd Dept. 1991); Pezrow Corp. v. Seifert, 197 A.D.2d 856, 602 N.Y.S2d 468 (4th Dept. 1994), mot. for leave to appeal dismissed, 83 N.Y.2d 798 (1994); Buffalo Imprints v. Scinta, 144 A.D.2d 1025, 534 N.Y.S.2d 55 (4th Dept. 1988); Altana, Inc. v. Schansinger, 111 A.D.2d 199, 489 N.Y.S.2d 84 (2nd Dept. 1985).

[8] Stanley Tuchin Associates, Inc. v. Vignola, 186 A.D.2d 183, 587 N.Y.S.2d 761 (2nd Dept. 1992); ICS/Executone Telecom, Inc. v. Mancuso, 178 A.D.2d 996, 578 N.Y.S.2d 334 (4th Dept. 1991); Inland Rubber Corp. v. Triple A Tire Service Inc., 210 F.Supp. 880 (S.D.N.Y. 1962).

[9] BDO Seidman, 93 N.Y.2d at 394, 690 N.Y.S.2d at 859; Briskin, 615 N.Y.S.2d at 167.

[10] Briskin, 615 N.Y.S.2d at 167; American Broadcasting Companies v. Wolf, 52 N.Y.2d 394, 438 N.Y.S.2d 482, 486 (1981); Victor Temporary Services v. Slattery, 105 A.D.2d 1115, 482 N.Y.S.2d 623 (4th Dept. 1984); Arias v. Solis, 754 F.Supp. 290 (E.D.N.Y. 1991); Innovative Networks, Inc. v. Satellite Airlines Ticketing Centers, Inc., 871 F.Supp. 709 (S.D.N.Y. 1995); J.H. Goldberg Co., Inc. v. Stern, 53 A.D.2d 246, 385 N.Y.S.2d 427 (4th Dept. 1976).

The enforceability of these restrictions also rests on the circumstances at the time the covenant was signed. Factors include whether the employee had counsel at the time and, if a termination was involved, the factors surrounding it.[11]

III. Preparing a Strategy for Negotiation

In preparing a strategy for limiting or eliminating your client's restrictive covenant, it is essential to analyze both the facts and the law. The factual analysis will include careful review of relevant documents, an investigation into the employee's position, skills and job experience, researching the company's prior enforcement history as well as its current market position, and the relevant financial and geographic marketplace. Once these facts are disclosed, and the relevant law applied, an attorney and her client can decide which issues to raise with the employer or its counsel.

Analyzing the Document

When analyzing an employment agreement, a word to the wise attorney: read it, reread it, and then read it again. Attorneys can often misread the scope of a restriction because they missed the placement of the commas in a compound sentence. Often, the language structure is obtuse and incomprehensible. An attorney needs to pay attention to the definition of words such as "customer" and "client" or any lack thereof. Finally, a restriction may have existed in a prior agreement, a policy guide, or a stock or option plan or agreement. Access it and read it aggressively.

Interviewing the Client

Having an understanding of what your client does for a living is primary. A job title is often misleading but a detailed job description may provide an entirely new context to the restriction. Your client's position within the company's hierarchy and how she arrived there is extremely relevant to negotiation. Determining what skills your client brought to the job, as opposed to skills that were developed on the job and how much was invested by the company, is relevant to any discussion of restrictions. As New York courts have recognized, an employee's close

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[11] Ticor Title Ins. Co., 173 F.3d at 66-68.

relationships with her employer's clients, especially when the employer expended resources to develop those special client relationships, may constitute "uniqueness" that makes a restriction binding. [12] Investigating the degree of contact your client had with customers and whether those customers are crucial to your client's future employment will lead the attorney to take a particular approach in negotiation. Determining if your client is a "profit center" and what damages may flow if the client competes is seminal. Finding out what your client's prospect is for new employment should also be considered before committing to a negotiating stance.

Researching the Company

It is essential to investigate the company's enforcement history and its motivation for enforcement. Are the goals punitive or is the company really concerned about losing business? If an employer has not litigated in the past, it is in a weakened position, as selective enforcement can hurt an employer's credibility. The employer faces serious risks in going to court, including: 1) the court invalidating its restrictions if it loses; 2) creating a litigious image that will dissuade talent from joining the company; and 3) creating ill will and morale for current employees. Can the company afford to litigate—not just financially, but in terms of its reputation? There are businesses that cannot afford the publicity of a nasty case against a key employee. Others thrive on legal battles that attract publicity and frighten employees considering an exit. In the latter, the enforcement history may fiercely limit your negotiation, where in the former, creative carve-outs and other suggested limitations can allow for a win-win negotiation.

Who Should Negotiate, Employee or Counsel?

Either an employee or her counsel can effectively negotiate restrictions. The key to success is understanding what is being asked of the employee, and being in a strong enough position, even if unequal, to negotiate. Although employees have the right to negotiate on their own behalf, they may be unversed in the legal terminology in the covenants or unsure of what rights are being sacrificed. Even if well informed, employees may feel undermined by the unequal nature of the relationship and unable to make their case effectively. To balance this, retaining counsel may be the first step toward leveling the playing field. However, where counsel may be viewed as an unwelcome challenge, employees often utilize counsel to work "behind the scenes" and guide

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[12] BDO Seidman, 93 N.Y.2d at 391-392, 690 N.Y.S.2d at 858-859 (1999).

them through the negotiation process. Understanding that the company has been represented by counsel in drafting these restrictions and an employee has the right to representation before agreeing to them, is essential.

First Steps

Counsel, with the employee, must always evaluate the consequences of negotiation. It may bring an employee's dissatisfaction to the employer's attention, which could result in an employee being fired or dampen the company's interest in a prospective employee. An employer will be more likely to negotiate with a high-level or uniquely talented employee. However, raising issues of competition can precipitate unwarranted concerns. If the employee is not overly concerned with being out of the job market for a while, he may agree to a restriction and worry about its enforcement later. Alternatively, he may request increased compensation or a more substantial severance package in exchange for the restriction. The employee and counsel may even conclude that the restriction is reasonable and represents good business. This too is a conclusion that should be reached sooner than later when evaluating the risks of negotiation. However, if the employee cannot function under the restriction or is leaving employment having already signed an agreement, assertive action may be the only alternative.

IV. Raising the Issue with the Employer's Counsel—Carve Out or Walk Out?

The act of bringing to the employer's attention that a restriction is overreaching signals that the employee will not passively accept it. Consequently, an employer may find it advantageous to reduce the scope of a restriction immediately, knowing that reasonableness today may avoid a legal quagmire tomorrow. Be aware, however, that criticism of a restriction without a concrete suggestion to revise it, or a well-thought-out reason to eliminate it, will only put the employer on the defensive and create an adversarial, often unproductive result. It may even cause your client to lose the job. On the other hand, carving out language that is not overly restrictive, but informs both parties of what is fair and reasonable in the industry, can lay the foundation for a positive outcome.

In reality, many employers maintain generic covenants that do not take into consideration the unique circumstances of a particular employee. The restrictions may have been drafted years ago and may not have been updated to reflect new state and federal regulations, changes in an employer's policies, or an altered marketplace. Approaching the employer with recent case law in hand and concrete, reasonable suggestions can set the stage for a positive negotiation.

When the employer is unyielding and responds with a take-it-or-leave-it approach, employee's counsel should not hesitate to advise the employer that New York state courts would be unlikely to enforce overly-broad restrictions. Advising the employer that the restriction only serves to undermine competition and prevent the employee from earning a living, and that New York courts will not tolerate this, may make it reconsider. Providing specific case law demonstrating that New York courts have chastised employers who coerce or pressure a prospective employee to sign overbroad restrictions as a condition of employment may also change the employer's mind and initiate a negotiation. In special circumstances, where there will be "lost profits" to an employer, counsel may offer a monetary incentive to remove the restriction.

When negotiation is stagnant, counsel has additional leverage in advising the employer's attorney that attorneys' fees will be sought in litigation. Courts have permitted an employee and her new employer to seek attorneys' fees in defending against enforcement of unenforceable restrictions. While the employer may have contemplated the costs of its own attorneys' fees in seeking enforcement, it may not have considered all the exposure it faces. This expanded risk of damages may cause employers to think twice before seeking to litigate and may well be the incentive required to obtain their cooperation.

V. Severance

In severance agreements there is unequal bargaining power but consideration to be bargained for. The critical questions for counsel to ask include: Was there a handbook or policy that established conditions for severance and included restrictions? Is the restriction appropriate or overbroad? Was the restriction bargained for or imposed under unfair bargaining conditions? Often the employee's counsel can remove the entire restriction or establish "garden leave" payment for the

duration of the restrictive period. If the employee is fired, counsel must question why any restriction should be imposed. Often, New York courts will wonder the same.

VI. Conclusion

Depending on the timing of negotiation, and whether a contract of employment exists, creative "carve-outs" rather than a "take it or leave it" approach may benefit both parties. Most important, a realistic assessment of the company's own risks in trying to enforce a restriction and its past history of enforcement can give an employee's attorney additional leverage and lead to a successful negotiation. Learning about your client's position early on, and what her duties have been at the company, can be critical to determining enforceability and will help you design a successful strategy for negotiation. Successfully negotiating out of restrictions at the beginning of employment could ultimately prevent your client from being a defendant in a lawsuit at its end.