

Protect Your Trade Secrets: Loopholes in Employment Contracts

And they're off! With the economy rousing from its recession-induced slumber, employers are returning to hiring mode and employees are quitting their jobs in increasing numbers. In 2011, 22.2 million private sector workers quit their jobs, up seven per cent from the previous year, according to the US Bureau of Labor Statistics.

Many of these on-the-move employees may end up at their former employers' competitors. Employers commonly use confidentiality agreements, non-compete agreements and non-solicitation agreements to protect their trade secrets and guard against unfair competition. These contracts, however, by nature or design, are not always as restrictive as hoped.

4 Common Mistakes

Here are some shortfalls found in employment contracts, gleaned from recent State and Federal Court rulings nationwide:

1. Unreasonably broad and overly burdensome non-compete agreements

Non-compete agreements may not be able to prohibit all business dealings between customers and former employees.

In *ISCO Industries, LLC v. Erdle*

(2011), the U.S. District Court for the Eastern District of North Carolina ruled that the non-compete agreement for a salesman at a customized piping solutions company was unreasonably broad in scope and overly burdensome. The contract, the Court noted, would have prohibited the salesman from selling "any product or services to any existing or prospective customers regardless of whether the product or services being sold are in competition with [the former employer]." Further, it prohibited the former employee from accepting "any payment from a third party doing business with [the former employer]."

2. Failure to show harm

Former employees sometimes dance along their non-compete agreements' restrictions, and former employers often jump the gun in crying foul.

In *Arizant Holdings, Inc. v. Gust*

(2009), the U.S. District Court for the District of Minnesota ruled that the former employee of a patient warning system producer and seller did not violate the terms of his non-compete contract by serving as a consultant and president for a start-up company that produced and

sold similar technology. During his tenure as president, the former employee was not involved in any of his company's sales, none of which occurred in his former sales territory. To avoid summary judgment, the Court said, the former employer "must do more than speculate about how it might

have been harmed; it must submit evidence that it was harmed."

3. Abrogating contracts with restrictive covenants with successive contracts

In *Arizant*

, the former employee had signed a confidentiality agreement. At the end of his employment, however, he signed a separation agreement designed to contain the "entire agreement between you and the Company with respect to your employment and separation from employment." The Court found that this contract made the previously signed confidentiality agreement a "dead letter."

4. Confusing confidentiality covenants with other covenants

Generally, a confidentiality agreement prohibits a former employee from disclosing protected information (e.g., trade secrets) to outside parties. Without a non-compete agreement or a non-solicitation agreement, a former employee may not be barred from dealing with the former employer's customers.

In *U.S. Re Securities, Inc., et al. v. Scheerer*

(2007), the New York Supreme Court, Appellate Division, First Department ruled that the former vice president of a reinsurance market brokerage and investment banking company did not violate his confidentiality agreement when he contacted his former employer's customers while working at its direct competitor. The former employer argued that the former employee would "inevitably disclose" proprietary information. The Court noted, however, that a "former employee's knowledge of the intricacies of a company [is] insufficient to establish breach of confidentiality agreement."

Get help

Employers concerned about the competitive ramifications of employee turnover should consult with an attorney familiar with the intricacies associated with contractual relationships in the business and employment law realm.