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About the BusinessAdvisor

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NONCOMPETITION AGREEMENTS AND THE PROTECTION OF PROPRIETARY INFORMATION

by Mary Hanson

Noncompetition agreements ("noncompete agreements", or "covenants not to compete") are interpreted and enforced according to state law, which differ greatly. Each agreement may be enforceable or unenforceable depending upon the state law that applies and the facts and circumstances of the particular agreement.

In addition, the courts of each of the states have a variety of concerns when cases arise involving restraining an individual from engaging in his or her known trade or business. This area of law, as a result, is not black and white.

Related laws which further complicate the issue of competition are those that protect the proprietary information of a business, including information a former employee would use in competing against that business.

In California, employees who seek to compete with a former employer may be pursued by the former employer based on laws protecting the former employer's proprietary information. An employee's right to compete is protected by law, but the employee has no right to use the former employer's proprietary information, whether or not the employee signed any agreement regarding the protection of such information.

Because it is well known that California law makes noncompetition agreements void and unenforceable, many employees may believe the law protects them more than in fact it does.

Noncompete Agreements

The historical background of non-compete agreements probably involves the old practice of apprenticeship. Employers were probably allowed to put employees under an agreement not to compete as part of the bargain in exchange for learning a trade or profession. Today the legal bias is primarily against such agreements between an employer and an employee. The main concern is the burden placed on a former employee who would be denied the ability to work in the trade or profession he or she knows.

The California law that makes non-compete agreements unenforceable (as in the case of employees) in fact allows the use of such agreements related to the sale of a business, or an ownership interest in a business.

The buyer of a business – or of an interest in a business, such as a partnership interest or corporate stock – can enter into a valid, enforceable agreement to restrain the seller from carrying on a similar business in the geographic area in which the business was carried on. In my view, every purchase of a business

or buyout of a co-owner of a business should contain a covenant not to compete, unless the purchase price is so low that there is really no "value" to the "goodwill" being purchased.

For example, if partners in a business merely split the assets of the business and go their separate ways, neither partner should expect to be able to limit the former partner's competition. But if a co-owner is bought out with a real purchase price for his or her partnership interest, membership interest, or corporate stock, the co-owner bought out should be required not to compete, and the buyer of the interest should be getting something in return for the purchase of goodwill.

Even if the buyer of a business expects the retiring seller not to compete, it is wise to include a noncompete provision in the agreement for purchase of the business. Since the purchase of a business is recognized under California law as a situation in which a real covenant not to compete is valid, this is the time to include such a provision in an agreement. It can provide a broad obligation of the seller to avoid engaging in activities that might impair the value of the business.

Even the seller of a business may not know what he or she might do after the sale of the business. Restrictions on a former owner of a business under a noncompete agreement can only be beneficial to the buyer of the business.

Of course, if you are the seller of a business, you want to avoid a non-compete agreement or at least have it limited in ways that permit you to pursue certain business activities – or certain geographic areas – that shouldn't be a concern to the buyer.

Proprietary Information and Nondisclosure Agreements

Whether an individual is an employee, an owner, or a contractor, competition by the individual may be legally restricted through a business's right to protect its proprietary or confidential information.

Even without any agreement, a business's proprietary information, confidential information, and trade secrets are protected by California law. It would be wise for employees to regard the use of or disclosure of a business's trade secrets as "theft" of such property. No matter that the information is intangible or that the information was developed by the employee, the law regards the information developed for an employer as belonging to the employer and regards it as something of value. Of course, some business information has no value, and some business information is readily and publicly available, but disputes rarely arise in such circumstances.

The long history and frequency of disputes between former employees and former employers has left a rich record of court cases interpreting almost every fact situation. Many of the cases involve customer lists and customer information. And it is worth noting that cases involving former employees' use of customer lists or customer information have been brought under California law protecting trade secrets and also under

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California law protecting businesses from unfair competition.

A former employee wishing to compete with a former employer – and do business with customers or clients of the former employer – must have a plan that not only carefully avoids using a customer list or customer information, but provides a persuasive trail of evidence of how business was solicited by the former employee – without the use of the former employer's information.

Nothing you can do can stop a former employer from making allegations and even initiating a lawsuit. What you can do is maintain a clean slate (e.g., no downloading of information, no telephone calls made to customers or clients, etc.) and maintain a trail of what WAS done (e.g., sending out a mass mailing to every individual on a particular trade association list).

Confidentiality Agreements

Although a business's confidential information is protected even without an agreement, a business wishing to protect its information should have a nondisclosure or confidentiality agreement signed by every business and individual that will have access to the information. By having an agreement that defines the obligation of confidentiality and having a practice of getting such agreements signed, the business resolves the questions that might be raised regarding (a) the obligation to protect information, (b) what information is subject to protection, and (c) whether the business is in fact taking steps to protect the information.

In addition to having agreements signed, any business that is serious about protection of trade secrets must take steps to limit and control access to the trade secrets. This not only strengthens any legal arguments regarding the confidential or trade secret status of the information, but also provides more meaningful protection than any agreement or any court can provide. An agreement does not prevent disclosure; it only gives the harmed party a basis for legal action.

Because of the nature of valuable information, you may never know that your information has been disclosed or used. There is no empty space left by purloined intangible information. You don't know if it's been taken, when it's been taken, how it's been taken, or where it went. You would most likely never know if an employee, a former employee, or an employee's brother-in-law, is using your information somewhere. An agreement does not change this fact.

If you are releasing information to another business under a non-disclosure agreement, you no longer control the environment in which your information might be accessed. You have no control over the employees of the business to which your information is disclosed.

Even if you know of a clear provable misuse or disclosure of your confidential information, you may not wish to take legal action against the wrongdoer. Legal action has its limitations and challenges. You would have the burden of proving that the information was misused or disclosed

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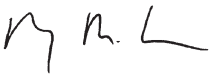
Publisher's Note

In California noncompete agreements are rather black and white compared to the fuzzy and complex subject of proprietary information. California law makes quite clear the circumstances under which noncompete agreements are enforceable and unenforceable. In other states the whole subject matter of restricting competition – either through the use of noncompete agreements or trade secret laws – is less clear. Many states have laws that permit the use of noncompete agreements. But many states' courts have a bias against preventing a former employee from pursuing his or her livelihood. Black and white it's not.

The area of protection of proprietary information presents many challenges. Chief among these challenges is that a signed nondisclosure agreement does not prevent disclosure or other use of information – either by the individual who signed the agreement or by someone else who has access to the information.

Nondisclosure (or "confidentiality") agreements are important. But I say even more important are policies and procedures that actually provide some protection against the information being taken or used.



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Attorney/Publisher

and that the information was confidential and entitled to protection. It takes time and money to get an injunction and/or money damages. The injunction and money damages, even if obtained, may not be what you expected and may take more effort and expense than they are worth. And your valuable information, having gotten out, may be used by other businesses without your knowledge.

Don't rely on an agreement to protect information. Rely on protective procedures. Different types of information require different procedures. Consider these policies, which might apply to many types of information:

- Do not disclose more information or more parts of the information than necessary.
- Do not disclose information until it is necessary. (Even then, only disclose what is necessary.)
- Do not disclose the information to more people than necessary.
- Do not allow uncontrolled access to valuable information. Keep valuable information in locked cabinets or under special passwords. (Even then, do not allow full access to all information, but only to the information necessary.)
- Put procedures in place limiting and tracking access to information. Maintain a log of who had access to what information.

There is no substitute for putting protective policies and procedures into effect. One cannot reverse the harm of disclosure. BA

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