Drafting Enforceable Noncompetition Agreements*

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Introduction

An employer who desires to protect his or her business from competitive harm caused by ex-employees utilizing the ex-employer's confidential business information has traditionally had several sources of protection: reliance upon the common law of trade secret misappropriation, use of covenants not to disclose, and use of employee noncompetition agreements. Thus, the employer is initially confronted with the question of determining which avenue of protection to pursue. This choice may be made more difficult in many instances because the employer may have doubts about resorting to the "untactful position" of requiring employees to sign restrictive covenants. For several reasons, however, it can be easily seen that the use of employee noncompetition agreements is the primary and most effective way to guard against unauthorized use of confidential business information by an ex-employee.

The common law of trade secret misappropriation protects under certain circumstances a firm's confidential business information from unauthorized use by an ex-employee (see, generally, R. Milgrim, Trade Secrets (1982)). Although no single formulation for imputing liability for trade secret misappropriation has been universally accepted, the courts are in general agreement that liability requires proof of two essential elements: that the information qualifies as a trade secret and that the ex-employee is using or threatens to use the trade secret to the ex-employer's detriment (see, generally, Hutter, "Trade Secret Misappropriation: A Lawyer's Practical Approach to the Case Law," 1 W. New Eng. 1 (1978)). It has long been recognized, however, that the law of trade secret misappropriation does not afford an employer adequate protection in many instances.

For example, in attempting to establish the "use" element of liability, the employer faces considerable evidentiary burdens. Where the claim is that the ex-employee is using or has disclosed the trade secret, proving this element, as one federal judge has noted, can be "an extraordinarily difficult task" since direct evidence is usually very difficult to obtain. See, Greenberg v. Croydon Plastics Co., 378 F. Supp. 806 (ED Pa. 1974). In situations in which relief is sought prior to actual use or disclosure the employer is confronted with the much oversimplified maxim that "every dog has one free bite. A dog cannot be presumed to be vicious until he has proved that he is by biting someone. As with a dog, the former

*From Protecting Trade Secrets 1983 (G4-3721) Submitted February 14, 1983
employer may have to wait for a former employee to commit some overt act before he can act: "Put another way, injunctive relief will not be granted merely upon the employer's belief or suspicion that its secrets will be used or disclosed to its detriment. Rather, the employer must establish that use or disclosure is "either imminent or eventually inevitable." Standard Brands v. Zumpe, 264 F. Supp. 254 (E.D. La. 1967).

Furthermore, even if the employer has established that the ex-employee has misappropriated its trade secrets, and the court has enjoined future use or disclosure of the trade secret by the ex-employee, a court will generally not enjoin on that basis the ex-employee from taking or continuing in competition with the ex-employer absent a valid noncompetition agreement. See, e.g., E. W. Bliss Co. v. Struthers-Dunn, Inc., 408 F.2d 1108 (8th Cir. 1969); Motorola, Inc. v. Fairchild Camera & Instrument Corp., 366 F. Supp. 1173 (D. Ariz. 1973); Clark Park & Manufacturing Co. v. Stenacher, 236 N.Y. 312 (1923). As explained by one commentator, "[M]ost courts take the view that the 'shield' which trade secret protection affords cannot be used to replace the 'sword' which can only be utilized in the context of an explicit and reasonable covenant not to compete." Blake, Restrictive Covenants in Employment Agreements in Protecting and Profiting From Trade Secrets 38 (PLI 1977). While there is some authority that an injunction enjoining competition would be appropriate, such authority is sparse, and the ground that it awards the injunction, i.e., disclosure of the information would be virtually inevitable, is a narrow one. See, Emery Industries, Inc. v. Cottier, 202 U.S.P.Q. 829 (SD Ohio 1978); Allis-Chalmers Manufacturing Corp. v. Continental Aviation and Engineering Corp., 255 F. Supp. 645 (ED Mich. 1966). The result is that the ex-employer, in order to ensure against use of its trade secret, is compelled to police the activities of its ex-employee. Such policing can prove to be difficult.

Another source of protection for the employer is a covenant not to disclose or use after termination of employment any confidential business information acquired by the employee during the course of his or her employment. The problem inherent in such covenants is that the employee upon termination of the employment could commence work with any firm, even a competing firm, and there would be no breach of the covenant so long as the employee honors the covenant. Such a covenant may then be difficult to enforce. Indeed, enforcement difficulty will be present even with the situation of an ex-employee who attempts in good faith to abide by his covenant, as the new employment may inevitably lead one to compromise his earlier intentions. As observed by one court, "The mere rendition of the service along the lines of his training would almost necessarily impart such knowledge to some degree. [The employee] cannot be loyal both to his promise to his former employer and to his new obligations to [his new employer]." Eastman Kodak Co. v. Powers Film Prods., Inc., 179 N.Y.S. 325, 330 (1919).

Confronted with the relative ineffectiveness of the forms of protection noted above, employers have come to rely upon noncompetition agreements. Indeed, it has been contended among the commentators that the use of employee noncompetition agreements is the primary device by which an employer can best protect his confidential business information against loss via the peripatetic employee, a view echoed by at least one court. The use of such agreements has
been advocated because they avoid the limitations inherent in the other sources of protection. Thus, in order to enforce such an agreement, it is not necessary for the employer to establish either actual or imminent use of confidential business information, but only that if the ex-employee commences work with his/her new employer, a breach of the covenant will occur. To be sure, the employer must establish the "reasonableness" of the noncompetition agreement, but this burden is usually less difficult than the burden of establishing actual or imminent use. Additionally, noncompetition agreements are advantageous because they are easier to police. If an ex-employee is prohibited from working for a competitor, he/she will have no opportunity to use or disclose his/her ex-employer's confidential business information. The only policing that is necessary is that of monitoring the subsequent business associations of the ex-employee.

For an employer, then, employee noncompetition agreements are the primary source of protection to guard against unauthorized use of confidential business information by ex-employees. Most courts, however, approach such agreements with great skepticism, recognizing that their enforcement interferes to some extent with an individual's freedom to pursue his/her calling, and with the mobility of talent within the economy. Consequently, careful drafting of these agreements is of utmost importance to employers. This paper endeavors to provide the basic background and legal guidelines needed by the practitioner who desires to draft an agreement that will be upheld and enforced by the courts. (For a more thorough citation and discussion of the cases, the reader's attention is directed to Hutter, Drafting Enforceable Employee Non-Competition Agreements to Protect Confidential Business Information: A Lawyer's Practical Approach to the Case Law, 45 ALB. L. REV. 311 (1981)).

I. Standards of Validity
   A. Common Law
      1. Nature and Scope of the Competitive Restriction

      Employee noncompetition agreements are generally valid under state law if "reasonable" in light of the circumstances. See generally, J. Thomas McCarthy, Trademarks and Unfair Competition § 29:10 (1973); Blake, Employee Agreements Not to Compete, 73 HARV. L. REV. 625 (1960). The verbal formulation of this standard by the New York Court of Appeals is fairly typical: "Such covenants will be enforced only if reasonably limited temporally and geographically... and then only to the extent necessary to protect the employer from unfair competition..." Columbia Ribbon & Carbon Mfg. Co. v. A-I-A Corp., 42 N.Y.2d 496, 499, 398 N.Y.S. 1004, 1006 (1977). From this statement of the standard, it is clear that there is a two-step approach to reasonableness: First, it is necessary to decide whether the noncompetition agreement is reasonably necessary to protect the legitimate needs of the employer and, second, whether the noncompetition agreement is reasonable with respect to the nature of the temporal and geographical restraints and the activity proscribed.

      These two aspects of reasonableness are of primary concern to those drafting an employee noncompetition agreement. What is reasonable or unreasonable will, of course, depend upon the facts and
Drafting Noncompetition Agreements

situation of each particular employer and employee. The draftsman, however, does not approach this subject without any guidance. Like most expressions of "reasonableness," the formulation of reasonableness for employee noncompetition agreements is an outline which has been expanded by judicial decisions. Analysis of these decisions suggests the limits to which a restraint can be enforced and what the draftsman must consider and do in order to prepare a "reasonable" agreement.

a. Employer's Interest

In its most basic terms the first aspect of reasonableness requires an examination into the business operations of the employer. A determination must be made as to whether there is a real need for protection or whether the agreement is simply being used to attain other objectives, i.e., protection from competition by ex-employees in whose training they have invested time and money and who are familiar with their business practices. With respect to the latter there can be no doubt that the courts are quite cognizant of the act that the "efficacy of these agreements invites abuse." Comment, 15 Colum. J. of L. & Social Probs. 181, 184 (1979).

The vast majority of the cases recognize that a real need for protection in the employment context will be present only in the following situations: (1) where the employer has legally protectable trade secrets to which the employee had access (for discussion and collection of the cases on this factor, see Annot., 41 A.L.R.2d 15, 102 (1955)); (2) where the employee has had access to confidential customer information or developed close relations with customers or clients (for discussion and collection of the cases on this factor see, Annot., 43 A.L.R.2d 94, 162 (1955), 41 A.L.R.2d 15, 71 (1955); or (3) where the employee's services are deemed special, unique, or extraordinary (for discussion and collection of the cases on this point, see Kniffin's "Employee Non-Competition Convenenta: The Perils of Performing Unique Services," 10 Rutgers-Cam L.J. 25 (1978)). To be sure, there is a line of cases developing which is not in accord with this statement. See e.g., Water Servs., Inc. v. Tesco Chem., Inc., 410 F.2d 163 (5th Cir. 1969); Continental Group, Inc. v. Kinsley, 422 F. Supp. 838 (D. Conn. 1976); Wilson Certified Foods, Inc. v. Fairbury Food Prods., 370 F. Supp. 1081 (D. Neb. 1974). These cases seem to hold that a "carefully spelled-out agreement can provide the basis for protection to matters which would otherwise not be entitled to protection." See R. Milgrim, Trade Secrets § 3.02(1) (1982). Numerous cases, however, reject this view. See Columbia Ribbon & Carbon Mfg. Co., Inc. v. A-I-A Corp. supra; J. Thomas McCarthy, Trademarks and Unfair Competition § 29:16 (1973).

Accordingly, where the draftsman is called upon to prepare a noncompetition agreement, he/she must initially consider whether one of the above three situations is present. In this regard, it must be borne in mind that self-serving statements by an employer will not
Drafting Noncompetition Agreements

suffice to establish any of these situations in the absence of solid evidence. *See Arthur Murray Dance Studios, Inc. v. Witter*, 62 Ohio L. Abs. 17, 55, 105 N.E.2d 685, 710 (1952). After the draftsman is satisfied that one or more of these interests is present, the agreement should specify the nature of the employer's interest being protected, the way or ways by which an employee may appropriate or undermine it, and the importance of protecting it from such action. Several reasons support this point. First, such language puts the employee on notice of the employer's claims and can make it difficult for the employee who signed the agreement to deny later that such an interest existed or that he/she had access to it or that he/she was in a position to appropriate it. Second, with respect to confidential business information that is claimed to be a trade secret, it provides an opportunity to define the trade secrets to which the employee has access. Such definition should be made in terms of use in business and the employee's knowledge by reason of his employment.

b. Scope of the Competitive Restriction

In considering the second aspect of reasonableness, the draftsman confronts a rather massive dilemma, making his/her job one that is fraught with uncertainty. The dilemma stems from the fact that the law on this aspect consists of a mass of factually distinct and irreconcilable decisions. Thus, it is frequently asserted that each case is to be determined on its own particular facts, and thus the same identical agreement may be reasonable and valid under one set of circumstances, and unreasonable and invalid under another set of circumstances.

Analysis of the decisions suggests, however, that the competitive restrictions on employment will be deemed reasonable if they: (1) cover a geographical area in which the possible use of the trade secrets or confidential information or employee's unique skills will pose a substantial threat to the employer's business; (2) last for a period of time which will legitimately reflect the expected life of the trade secret or other confidential information and not impose undue hardship on the particular employee; and (3) restrict competition in the specific type of business activity in which the employee was engaged or in which potential competition is a realistic possibility. Blake, *Restrictive Covenants in Employment Agreements in Protection and Profiting From Trade Secrets* 36-37 (1975).

Each one of these factors will now be separately considered. While discussion is limited to one factor at a time, it must be kept in mind that in a determination of overall reasonableness they are not independent and unrelated aspects of the non-competition agreement. Courts, naturally, do not consider each territorial, temporal, and activity restriction in the agreement in the abstract without reference to each other, and the reasonableness of each such restriction depends, to some extent, on the severity of the other

(i) Territorial Restrictions

It is well established that the old view that any territorial restraint covering an entire state, or the motion is per se unreasonable is no longer valid. Williston, Contracts § 1638 (1957). The modern view is that the reasonableness of the territorial restraint depends not so much on the geographic size of the territory as on the reasonableness of the restriction in view of the facts and circumstances of the case. See Budget Rent-A-Car Corporation of America v. Fein, 342 F.2d 509, 518 (5th Cir. 1965). In this regard territorial restrictions are generally considered reasonable to the extent they include an area in which the potential use of the trade secrets, confidential customer information, or extraordinary or unique skills of the employee poses a significant threat to the business of the employer. See Boldt Machinery & Tools, Inc. v. Wallace, 469 Pa. 504, 366 A2d 902 (1976); Contractors Co. v. Hurley, 365 Mass. 280, 310 N.E.2d 915 (1974); Harwell Enterprises, Inc. v. Heim, 276 N.C. 475, 173 S.E.2d 316 (1970). Pursuant to this view courts are becoming less likely to strike down a broad territorial restriction as unreasonable as they are recognizing in light of national industries and businesses, and the free mobility of employees and information, that such restrictions are necessary to protect against the use of trade secrets or other business information by ex-employees, or competition from ex-employees with unique skills. See e.g., Bender, Trade Secret Protection of Software, 38 Geo. Wash. L. Rev. 909, 934 (1970); Blake, Employee Agreements Not to Compete, 73 Harv. L. Rev. 625, 679-81 (1960); Mixing Equipment Co. v. Philadelphia Gear, Inc., 436 F.2d 1308, 1314 (3d Cir. 1971); Monogram Industries, Inc. v. SAR Industries, 134 Cal. Rptr. 714, 721 (1976). These situations are to be distinguished from those involving sales activities by ex-employees wherein the courts generally hold broad restraints invalid. Blake, Employee Agreements Not to Compete, 73 Harv. L. Rev. 625, 679-81 (1960).

Accordingly, if an employer's industry is a national industry, or if the employer has customers throughout the nation, or if the employer faces competition throughout the nation, a nationwide restrictive covenant will be deemed valid. See, e.g., Briggs v. R. R. Donnelley & Sons Co., 446 F. Supp. 153 (D. Mass. 1978); Continental Group, Inc. v. Kinsley, 422 F. Supp. 838 (D. Conn. 1976); Gillette Company v. Williams, 360 F. Supp. 1171 (D. Conn. 1973); De Long Corp. v. Lucas, 176 F. Supp. 104 (S.D.N.Y. 1959), aff'd, 278 F.2d 804 (2nd Cir. 1960). If the circumstances surrounding the restrictions do not
Drafting Noncompetition Agreements

fit into one of the above mentioned competitive situations, a nationwide restriction will not be upheld. See J. Thomas McCarthy, Trademarks and Unfair Competition § 29:13 (1973); International Election System Corp. v. Shoup, 452 F. Supp. 684, 698 (E.D. Pa. 1978). In this situation, the restriction should be drafted to include only the geographical area where the employer needs protection. See, e.g., Matrix Corp. v. Faber, 104 Ohio App. 8, 146 N.E.2d 447 (1957) (nineteen states and Canada); Novelty Bias Binding Co. v. Shevin, 342 Mass. 714, 175 N.E.2d 374 (1961) (twenty-six states).

In sum, the permissible territorial coverage of a competitive restraint is limited to that area in which the employer could suffer economic harm from the employee's activities. Therefore, in order to optimize the likelihood that a noncompetition agreement will be upheld, the draftsman must assure himself/herself that the desired geographical area is supportable in light of the employer's need for protection.

(ii) Time Restrictions

The permissible duration of a covenant not to compete presents a difficult drafting problem. Examination of the cases provides decisions supporting and invalidating any time restraint, from less than one year to unlimited durations. See, Annot., 41 A.L.R.2d 15 (collecting cases). Two points are, however, to be gleaned from the cases. Initially, it is to be noted that its reasonableness depends in many instances on the territorial restriction. As one commentator has observed, "One may lawfully agree not to compete in a particular business, in a reasonably limited territory, during the remainder of his life. . . . Where a restraint provides for a limited period of time, it may be enforceable although it is not limited in point of space," Williston, Contracts § 1638 (1957). Secondly, common to all these cases is that a time restraint will be upheld where there is a demonstrated need for protection over that stated period of time. Blake, Employee Agreements Not to Compete, 73 Harv. L. Rev. 625, 677-678 (1960).

Where the noncompetition agreement is being imposed for the purpose of protecting the employer's trade secrets, a specified time limitation would appear to be valid so long as it does not exceed the useful life of the trade secret or, where the secret is theoretically perpetual in duration, extend beyond the time it would take to develop independently the secret. See e.g., Rector-Phillips-Morse, Inc. v. Vroman, 253 Ark. 750, 489 S.W.2d 1 (1973). Eastman Kodak Co. v. Powers Film Prods., Inc., 189 A.D. 556, 179 N.Y.S. 325 (1919); Bender, Trade Secret Protection of Software, 38 Geo. Wash. L. Rev. 909, 934 (1970); Blake, Employee Agreements Not To Compete, 73 Harv. L. Rev. 625, 677-678 (1960); cf., K-2 Ski Co. v. Head Ski Co., 506 F.2d 471 (9th Cir. 1974); Plant Industries, Inc. v.
Drafting Noncompetition Agreements

Coleman, 278 F. Supp. 636 (C.D. Cal. 1968); Todd Chem. Co. v. Distefano, 30 A.D.2d 879, 292 N.Y.S.2d 811 (1959). This standard seems appropriate since it denies the ex-employee unjust enrichment and gives the employer sufficient protection for its interests. It is to be noted that this is the standard the courts utilize in determining the duration of injunctive relief upon a finding of trade secret misappropriation. R. Milgrim, Trade Secrets § 7.08 (1) (1982); Annot., 28 A.L.R.3d 7, 131-135.

When the restraint is being imposed upon the basis of the customer or client interest, the courts generally hold that the time duration is reasonable "only if it is no longer than necessary for the employer to put a new man on the job and for the new employee to have a reasonable opportunity to demonstrate his effectiveness to the customers." Blake, Employee Agreements Not to Compete, 73 Harv. L. Rev. 625, 677 (1960) (collecting cases). Analysis of the cases gives further guidance in that it indicates that "when an employee's contacts with the customers are regular and frequent a shorter period of time is needed by the employer than when, as here, the contacts are made at relatively long intervals." Lakeside Oil Co. v. Slutsky, 8 Wis.2d 157, 164, 98 N.W.2d 415, 420 (1959).

Accordingly, the permissible time restraint will turn upon what interest an employer is attempting to protect and whether the specified period of time is rationally related to achieving protection of that interest. Thus, in drafting a time restraint to support trade secret protection, its effective period should not run beyond a period corresponding to the trade secret's useful life or where the trade secret will not necessarily become obsolete over the passage of time, beyond the period it would take to develop the trade secret independently. For many trade secrets, this period may not last longer than a few years, but for others it may last considerably longer. The facts before the draftsman will consequently dictate what will be an appropriate period of time. If the protectible interest is the customer or client interest, the duration of the non-competition agreement should be no longer than it would take the employer to train a new employee to assume effectively the ex-employee's duties. This, too, will depend upon the facts before the draftsman. In any event, in both instances the specified period should be factually supportable.

(iii) Activity Restrictions

The last factor the courts analyze in determining reasonableness is the scope of the activities that the agreement prohibits the employee from performing. With respect to this factor, the courts adhere to the view that the activity restriction must be similar to the nature of the activities that the employee was engaged in during the course of his employment. Karpinski v.
Ingrasci, 28 N.Y.2d 45, 320 N.Y.S.2d 1 (1971); PEMCO Corp. v. Rose, 257 S.E.2d 885 (W. Va. 1979); Blake, Employee Agreements Not to Compete, 73 Harv. L. Rev. 625, 675-677 (1960).

Pursuant to this view, a restraint that prohibits the employee from obtaining employment with a competitor of the employer in any capacity (e.g., supervisor of manufacturing or salesman, later employed as non-salesman) will be deemed unreasonable. See, H & R Block v. McCaslin, 541 F.2d 1098 (5th Cir. 1976). Similarly, a restriction which would prohibit an employee with a specialized background from working in his/her general area of expertise for a company that does not compete with the employer, e.g., chemist in waste disposal, later employed as chemist in bio-medical research will be held invalid. See Electronic Data Syst. Corp. v. Kinder, 360 F. Supp. 1044 (N.D. Tex 1973). Likewise, a restraint which would prohibit a salesman from soliciting firms which were not customers of his/her employer during his employment will be considered unreasonable. See, Gill v. Computer Equip. Corp., 266 Md. 170, 292 A.2d 54 (1972).

Common to all these cases, such restrictions were unnecessary to protect any legitimate interest of the employer. Thus, the draftsman shall draft a restriction that will encompass only a specific activity or activities in which there is a realistic possibility that competition from an ex-employee will be harmful to the employer's legitimate interests.

2. Consideration

Generally, competitive restrictions are unenforceable unless they are supported by consideration. See Maid Cook-Ware Corp. v. Hamil, 50 F.2d 830 (5th Cir. 1931); James C. Greene Co. v. Kelley, 261 N.C.166, 134 S.E.2d 166 (1964); McCall v. Wright, 198 N.Y. 143, 91 N.E. 516 (1910); Williston, Contracts § 137A (1957).

Thus, despite the existence of protectible employer interests and restrictions which are reasonably necessary for the protection of such interests and are reasonably limited in geographical extent, duration and activity to be proscribed, a noncompetition agreement may nevertheless be rendered unenforceable if there is a lack of consideration.

a. Commencement of Employment

Where the contract of employment is terminable at will, there has been some divergence among the jurisdictions as to whether the employment is consideration. While most courts have held that a hiring at will supplies the necessary consideration or employment at will that lasts a period of time is adequate consideration, other courts have concluded that such employment does not constitute sufficient consideration for a covenant not to compete. See R. Milgrim, Trade Secrets § 3.05(1)(e) (1982); Williston, Contracts § 1643 (1957). In order to avoid invalidity on this ground, it is suggested that when at will employment is involved, the draftsmen
Drafting Noncompetition Agreements

include in the employment agreement a mutual notice clause. In these circumstances, the authority appears unanimous that sufficient consideration is present. See e.g., Maloney v. E.I. duPont de Nemours & Co., 352 F.2d 936 (D.C. Cir. 1965), cert. denied, 383 U.S. 948 (1966); Bender, Trade Secret Protection of Software, 38 Geo. Wash. L. Rev. 909, 935 (1970).

b. Post-Employment

Where an employee executes a restrictive covenant some time after employment is begun, questions arise as to what constitutes adequate consideration for the covenant in such circumstances. See generally, annot., Sufficiency of Consideration for Employee's Covenant Not to Compete, Entered Into After Inception of Employment, 51 A.L.R.3d 825 (collecting cases). Many courts hold that where the employee executes a covenant not to compete during the course of his employment and receives nothing tangible other than the continuation of employment, insufficient consideration is present. R. Milgrim, Trade Secrets § 3.05(e) (1982) (collecting cases). These courts look for "fresh" consideration to uphold the covenant, such as promotion or enhanced job responsibilities. E.g., Forrest Paschal Mach. Co. v. Miholen, 27 N.C. App. 678, 220 S.E.2d 190 (1975), additional salary compensation (e.g., Technicolor v. Traeger, 551 P.2d 163 (Haw. 1976), or the immediate payment of retirement benefits (e.g., Marine Contractors Co. v. Hurley, 365 Mass. 280, 310 N.E.2d 915 (1974). Other courts hold that the mere continuation of the employment by the employer constitutes sufficient consideration. See Annot. 51 A.L.R.3d 825, 835-39. However, even in these states, there is some question as to the applicability of the rule when the employee is already contractually bound for a period of time prior to signing the covenant. Cf., Middlesex Neurological Associates, Inc. v. Cohen, 324 N.E.2d 911 (Mass. App. 1975).

The potential defense of lack of consideration can be easily eliminated. At the time the covenant is executed, an increase in salary, a promotion, a new title or new job responsibilities, increased fringe benefits, an additional term of employment or anything else of some benefit, should be given to the employee.

B. Statutory

1. State Statutes

2. Specific Statutes


3. Federal Antitrust Statutes


Section 2 of the Sherman Act, 15 U.S.C. section 2 (1970) outlaws monopolization and attempts to monopolize. Where noncompetition agreements are used in an effort to monopolize or attempt to monopolize a part of trade or commerce, such use can lead to a violation of section 2. See Sas Industries, Inc. v. Monogram Industries, Inc., 1976-Trade Cos. A 60, 816 (C.D. Cal. 1976). As the Supreme Court has observed, "It is not enough that the agreements may be valid under local law. Even an otherwise lawful device may be used as a weapon in restraint of trade or in an effort to monopolize a part of trade or commerce.... If, we had here only agreements not to compete, the inferences drawn by the District Court might not be warranted. But in the setting of this record, and against the background of Schine's other monopolistic practices, it seems to us that the District Court might infer that the requisite purpose was present and that these agreements were additional weapons in Schine's arsenal of power through the use of which its monopoly was sought to be extended" Schine Chain Theaters, Inc. v. U.S., 334 U.S. 110, 119 (1948).

II. Optimizing the Employer's Objective of Preventing Harm: Additional Clauses

A. Choice of Law Clause
It is a valid possibility that an employee noncompetition agreement which is enforceable in one state may nevertheless be ruled void in another state and in still a third state be modified to be reasonable and then enforced. Thus, the law which governs the agreement's validity and enforceability is crucial. Accordingly, the draftsman should include in the agreement a clause specifying which state's law is to govern the agreement. In the absence of such a clause, the court which is asked to enforce the agreement will apply the law dictated by the forum court's conflict of law rules. See Award Incentives, Inc. v. Van Rooyen, 263 F.2d 173 (3rd Cir. 1959).

Traditionally, where parties have manifested their intent to have an agreement governed by the law of a particular state, their intent has been honored. See Buono Sales, Inc. v. Chrysler Motor Corp., 363 F.2d 43 (3d Cir. 1966); Freedman v. Chem. Constr. Corp., 43 N.Y.2d 260, 401 N.Y.S. 2d 176 (1977); Restatement, Second, Conflict of Laws § 187 (1971). The state whose law the parties intend to apply, however, must bear a reasonable relation to the agreement. See, A.S. Rampell, Inc. v. Hyster Co., 3 N.Y.2d 369, 165 N.Y.S. 2d 475 (1957); Restatement, Second, Conflict of Laws § 187, Comment f (1971). Thus, the state whose law is chosen should be either the place of negotiation, execution or performance. R. Milgrim, Trade Secrets § 3.02(1)(9) (1982); Annot., 16 A.L.R. 4th 967 (1982).

Recently, some courts have refused to enforce a noncompetition agreement even though valid under the law of the state stipulated to be applicable because the agreement was deemed to be contrary to the public policy of the forum state. See Merrill Lynch, Pierce, Fenner & Smith v. Stidham, 658 F.2d 1098 (5th Cir. 1981); Frame v. Merrill Lynch, Pierce, Fenner & Smith, 97 Cal. Rpts. 811 (1971). These holdings, it is to be noted, are at variance with the Restatement and have been strongly criticized. As one commentator has observed, "It is inconsistent to permit an employee to retain all the benefits of an employment commenced and largely conducted in one jurisdiction, and then to deny the employer the right to enforce restrictive covenants valid in that jurisdiction but not valid in the jurisdiction to which the employee may move. Indeed, to so apply public policy would make havens of states having anticompetitive statutes for employees from other jurisdictions whose competitive activities might inevitably jeopardize their former employer's trade secrets." R. Milgrim, Trade Secrets § 3.02(1)(9) (1982). Such authority and criticism may lead courts in the future not to invalidate noncompetition agreements upon the ground that they violate the forum state's public policy.

B. Termination Clause

The noncompetition agreement should provide that its provisions will apply after termination of employment "for any reason." This language will prevent the situation that was present in Leo Silfen Inc. v. Cream (25 N.Y.2d 387, 278 N.E.2d 636 (1972) from occurring. In Silfen, the employee had executed a noncompetition agreement, but it applied only if the employee terminated the relationship. Subsequently, the employer discharged the employee. The employee then opened a competing
business. The New York Court of Appeals held that the employee could not be enjoined pursuant to the agreement, because under the termination clause the agreement was not applicable if the termination was the result of the employer's conduct.

C. Exit Interview and Successive Employment Notice Clause

Regardless of the legal validity of a noncompetition agreement, it is of no value to an employer who is not aware that the employee is in fact violating its terms. A solution to this problem is for the draftsman to include in the agreement a clause providing for an "exit interview" process and requiring from the employee advance notice informing the employer for whom the employee will work and in what capacity.

With respect to the "exit interview" process, the clause should specify that prior to termination of the employment, the employee must meet with the employer. Such a meeting will provide the employer with an opportunity to review with the employee the terms of the noncompetition agreement and the employee's obligations under it, along with a reminder that the employer is prepared to enforce the agreement and that the employee cannot remove from the employer's premises, and must return, any confidential matter to which he/she has access. This "exit interview" can be beneficial to the employer in two ways. First, it may dissuade the employee from ever attempting to engage in activities that would necessitate a violation of the agreement. Second, it may alert the employer that the employee is about to engage in competitive activities, and thus that close monitoring of his/her subsequent activities is warranted.

The purpose of the clause requiring advance notice informing the employer for whom the employee will work and in what capacity is twofold. First, the employer will know where the employee will be working and such knowledge can help in determining whether the agreement will be violated or in determining that monitoring is warranted. Secondly, if the employer can ascertain from this information that the employee will break the agreement, the employer is in a position of informing the new employer of this and thus alerting this employer to the possibility of an interference with contractual relations lawsuit. The threat of such a suit may deter the hiring of the employee.

1. Computation of Time Limitation Clause

In a recent decision, an employer was denied enforcement of a covenant not to compete because the time period of the restraint had expired while its case was being litigated in a federal court. See A-Copy, Inc. v. Michaelson, 599 F.2d 450 (1st Cir. 1978). This occurrence is not a rare one. To the contrary, the courts have indicated that when the period of restraint has expired, even where the delay was substantially caused by the time consumed in litigation, specific relief is inappropriate, and the employer is left to his or her damages remedy, if damages are provable. See All Stainless, Inc. v. Colby, 364 Mass. 773, 308 N.E.2d 481 (1974); Abilene Pest Control Service, Inc. v. Hall, 126 Vt. 1, 220 A.2d 717 (1966); Gordon v. Landau, 49 Cal.2d 690, 321 P.2d 456 (1958). But see Premier Industrial Corp. v. Texas Industrial Fastener Co., 450 F.2d 444 (5th Cir. 1971).
To prevent this situation from occurring the draftsman should include in the agreement a clause which provides that the time limitation of the competitive restraint shall be the specified duration, computed from the date the relief is granted but reduced by the time between the period when the restriction began to run, i.e., at the termination of employment, and the date of the first violation of the covenant by the employee. Such a clause will not only prevent the harm that can arise from application of the rule recognized in A-Copy, but will also give the employer the benefit of the full period of the agreement.

E. Compensation Clause

Some courts, in determining whether a noncompetition agreement is reasonable, have injected the factor of personal hardship that would be suffered by the employee if the agreement were to be enforced. See e.g., Standard Register Co. v. Kerrigan, 119 S.E.2d 533, 238 S.C. 54 (1961); Annot., 43 A.L.R.2d 94, 212-13, 221-26 (1955). To preclude this and to provide affirmatively other indicia of reasonableness, the draftsman may want to include a clause which provides that if an employee is unable to find suitable employment after a conscientious effort to do so, the employer will make predetermined payments of money based upon his former salary. To be sure, the cost of such a clause may be high but it will be a relatively cheap bargain if a court relying on this clause determines the noncompetition agreement to be reasonable and enforces it. Cf. Emery Indus., Inc. v. Collier, 202 U.S.P.Q. 829 (S.D. Ohio 1978) (Court enjoined the employee from taking new job, but ordered the employer to pay the employee $330 per month).

F. Arbitration Clause

In a recent decision the New York Court of Appeals held that an arbitrator’s award enforcing the terms of a noncompetition agreement should be enforced. Sprinzen v. Nomberg, 46 N.Y.2d 623, 415 N.Y.S.2d 974 (1979). The court ruled that the arbitration of noncompetition agreements does not violate public policy. On the other hand, the courts in California are of the view that arbitration is not permitted to enforce noncompetition agreements. Merrill Lynch, Pierce, Fenner & Smith v. Ware, 100 Cal. Rptr. 791, aff’d, 414 U.S. 117 (1973).

If under the applicable substantive law an arbitrator has the power to compel compliance with the terms of the noncompetition agreement, the inclusion of an arbitration clause is a worthwhile consideration for the draftsman. This conclusion follows for several reasons. First, since an arbitrator is not bound to abide by principles of substantive law, the arbitrator may enforce a noncompetition agreement that a court would not have enforced, had the enforceability of the agreement been adjudicated in the courts. Second, arbitration offers many procedural advantages, such as: arbitrators are not bound by courtroom rules of evidence, arbitration proceedings can be held outside of the public eye, and there is no opportunity for appeal on the merits. Furthermore, the arbitrator can be required to have certain requisite qualifications and a general technical background or background in the industry in which the agreement is being used.
One caveat about the use of an arbitration clause must, however, be mentioned. The law is unclear whether a court can grant preliminary relief to enjoin a violation of the agreement when the agreement provides for arbitration. Thus, the employer must consider the possibility that the employee will compete against it prior to and during the arbitration procedure, and that judicial relief may be unavailable. While there is the possibility of preventing this situation from occurring by adroit draftsman­ship, namely a clause providing for the right to obtain equitable relief from a court apart from the arbitration proceeding, or a clause which specifies that the initiation of an arbitration proceeding will have the effect of a court injunction and that pending the outcome of the proceeding the parties shall maintain the status quo, the draftsman should be alerted that no authority for the proposition that such clauses are valid can be cited.

G. Continuation of Employment Past Contractual Time Period

A recent decision, Hubbell v. Hubbell Highway Signs, Inc., 77 A.D.2d 923, 422 N.Y.S.2d 199 (1979), presented a situation which should raise concern for the employer. Hubbell had entered into an employment contract with the defendant corporation in August, 1968. The contract was for five years and contained a noncompetition clause that prohibited him from competing for three years following the termination of his employment under the contract. Hubbell worked for the company until May, 1978. At no time was the contract extended or renewed. The court held that the noncompetition clause could not be enforced in 1978 because under the language of the contract it had no force or effect after August, 1976. The fact that Hubbell remained as an employee without contract did not make the noncompetition clause effective, in the absence of a written agreement to the contrary.

The draftsman should cover the Hubbell situation. While it may be most appropriate for the firm to enter into a new contract or renew the old one after the expiration of the original contract, at the very least the draftsman should state that the time period of the covenant shall start running whenever the employee terminates his/her employment.

H. Assignment Clause

While some courts have held that non-competition agreements are assignable, see Peters v. Davidson, Inc., 172 Ind. App. 39, 359 N.E.2d 556 (1977); Norman Ellis Corp. v. Lippus, 13 Misc. 2d 432, 176 N.Y.S.2d 5 (1955), other courts have held that they cannot be assigned. See Avenue Z Wet Wash Laundry Co. v. Yarmush, 129 Misc. 427, 221 N.Y.S. 506, affd. 220 App. Div. 740, 221 N.Y.S. 788 (1927). However, there appears to be a unanimity of opinion that noncompetition agreements are assignable if there is an express clause permitting such assignment. See Abalene Pest Control Service, Inc. v. Hall, 126 Vt. 1, 220 A.2d 717 (1966); National Lines Service Corp. v. Clower, 179 Ga. 136, 175 S.E. 460 (1934). In view of this line of cases, an assignment clause should be provided for.

I. Severability Clause

If the covenant not to compete is determined to be unreasonable in time, territory, or activity, three approaches have been followed by the
Drafting Noncompetition Agreements

Courts. See Annot. 61 A.L.R.3d 397 (collecting cases). They are: (1) deny enforcement of the entire covenant if any part is found to be unreasonable; (2) modify the covenant if the covenant is so worded that the excessive terms can be crossed out and the remaining terms are sufficient to constitute a valid covenant and enforce the covenant as so modified; and (3) reform the covenant as a whole without regard to the severability of its terms and enforce a reasonable restraint as determined by a court. See generally, J. Thomas McCarthy, Trademarks and Unfair Competition § 29:19 (1973).

The first approach is grounded on the view that a policy of granting partial relief amounts to a judicial rewriting of the contract. This view has some support in the cases. E.g., Rector-Phillips-Morse, Inc. v. Vroman, 253 Ark. 750, 489 S.W.2d 1 (1973); Note, 29 Ark. L. Rev. 406 (1975). The second approach, often referred to as the “blue pencil rule,” has been supported by the courts and the Restatement of Contracts § 518 (1932) on the ground of fairness. It is important to note that this rule permits a court to enforce what it feels are reasonable terms under the circumstances, but only if the terms of the contract are severable. E.g., Tminsteral, Inc. v. Dogata, 29 Conn. Supp. 180, 277 A.2d 512 (1971).

The third approach is based on the notion that the strict divisibility requirement produced questionable results. See Ehlers v. Iowa Warehouse Co., 188 N.W.2d 368, modified, 190 N.W.2d 413 (Iowa 1971). A majority of the courts have adopted this view on the ground that it provides a court more flexibility. See Corbin, Contracts § 1390 (1962) (supporting this rule). It has, however, been criticized because it invites employers to draft excessive restrictions since they know that the courts will enforce whatever they deem reasonable. Such excessive restraints could serve to intimidate employees and deter third parties from attempting to hire the employee. Blake, “Employee Agreements Not to Compete,” 73 Harv. L. Rev. 625, 682-683 (1960).

Of what significance to the draftsman of a noncompetition agreement is this conflict among authorities? Several points must be noted. First, if the applicable law includes decisions which recognize the “blue pencil” test, good draftsmanship would dictate that the restraints be drafted with an eye towards their severability. Thus, instead of preventing the employee from competing in “New England,” the agreement should specify the six New England states separately. Similarly, a time limitation should be expressed as — for example, a three year period — for “one year, or two years, or three years,” or alternatively, “in 1980, 1981, or 1982;” and an activity limitation would be written as, for example, “dentistry and/or oral surgery.” Secondly, if the applicable law prohibits any modification, the draftsman should not rely upon a clause in the agreement which grants a court the right to partially enforce the agreement, because the cases seem uniform in holding that such a clause will not be recognized upon the ground that it is an improper attempt to delegate to the court the power to make a new contract. Lastly, if the applicable law permits partial enforcement, the draftsman should not draft as broad an agreement as conceivably possible, regardless of the
factors and circumstances surrounding the agreement, in the hopes that the limitations will be subsequently modified to the extent that reasonableness demands, because many courts in such a situation will deny even partial enforcement.

III. Avoid Unfairness in Termination

Regardless of how "reasonable" a noncompetition agreement may be, the law is clear that the agreement will not be enforced when the employee is terminated in an unfair manner. Thus, in a leading case, *Economy Grocery Stores Corp. v. McMenamy* (290 Mass. 549, 195 N.E. 747 (1935), the Supreme Judicial Court of Massachusetts, after noting that the employee was fired without cause and in circumstances involving some humiliation to him, refused to enforce a noncompetition agreement that appeared reasonable. The court held that "specific performance . . . will not be granted if the conduct of the plaintiff (employer) isavored with injustice." Similarly, other courts have refused to enforce a noncompetition agreement when the employer was responsible for the breach of the contract containing the covenant. See *Cornell v. T.V. Development Corp.*, 17 N.Y.2d 69, 268 N.Y.S.2d 29 (1966); *Millet v. Slocum*, 4 A.D.2d 528, 167 N.Y.S.2d 136 (1957), aff'd 5 N.Y.2d 734, 177 N.Y.S.2d 716 (1958).

The teaching of *Economy Grocery* is clear. An employer should exercise caution in terminating employment which is subject to a noncompetition agreement in order to avoid a charge that he/she is acting in bad faith. Otherwise, all the effort put into drafting an enforceable agreement will be for naught.

IV. Conclusion

Before drafting a noncompetition agreement to protect a firm, the draftsman should become fully knowledgeable about the employer's business and the employee's position and relationship to that business. To this end, he/she should thoroughly discuss with the employer the business interests which the employer is entitled to protect, ascertain whether the employer in fact has a protectible interest, discover the possible harm the employee could bring to that interest, explain the legal limits of the protection that can be afforded that interest, and determine the extent of contractual provisions that the employer can live with. Having done this, the draftsman can draft the competitive restrictions concerning geography, time and activity to the maximum necessary to protect the employer's legitimate interest. Additionally, the draftsman will then be in a position to avoid future lack of consideration problems, and include in the agreement certain clauses which can optimize the employer's ultimate objective of preventing harm from its ex-employee.

To be sure, the drafting of an enforceable noncompetition agreement can be a task which is fraught with uncertainty. Nevertheless, numerous cases have been reported wherein such agreements have been upheld and employees held to their terms. The key to all these decisions was reasonableness, and a draftsman who follows the suggestions made in this paper should have little trouble in convincing a court that the agreement he/she drafted was in fact reasonable.