

# USING RESTRICTIVE COVENANTS TO PROTECT YOUR BUSINESS INTERESTS

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# WHAT WE WILL COVER

- Overview of Applicable Law
- Types of Restrictive Covenants
- Guidelines for Drafting
- Enforcement
- Defenses

# LAW GOVERNING RESTRICTIVE COVENANTS

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# LEGAL REQUIREMENTS

- Varies by state, but generally a restrictive covenant must:
  - Be supported by adequate consideration
    - Some states: Mere continued employment
    - Other states: New consideration

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# LEGAL REQUIREMENTS

- Protect a reasonable competitive business interest
  - “The reasonableness of a [restrictive covenant] is not analyzed in the abstract, but in the context of the employer’s particular business interest and the function and knowledge of the particular employee.” *Whirlpool Corp. v. Burnns*, 457 F. Supp. 2d 806, 812 (W.D. Mich. 2006)
  - Customer relationships and goodwill
  - Confidential business information
  - Specialized training

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# LEGAL REQUIREMENTS

- Be reasonable as to duration
  - Consider the realistic life of the confidential information or competitive advantage being protected
  - Generally six months to three years is considered reasonable
  - Some states will reduce overly broad restrictions

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# LEGAL REQUIREMENTS

- Be reasonable as to geographic scope
  - “The guiding principle is that such geographic limitations must be tailored so that the scope of the agreement is no greater than reasonably necessary to protect the employer’s legitimate business interests.” *Certified Restoration Dry Cleaning Network LLC v. Tenke Corp.*, 511 F.3d 535, 547 (6th Cir. 2007)
  - Courts have found an unlimited geographical scope reasonable if the employer’s business is, and the employee’s employment was, sufficiently national and international in scope
  - City, county or state restriction may be appropriate if employee only worked in that area
  - Some states will reduce overly broad restrictions
  - Does not apply to non-solicitation restrictions

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# LEGAL REQUIREMENTS

- Be reasonable as to type of employment/line of business
  - Courts have sometimes struck down non-competition agreements that prohibit an employee from working for a competitor in any capacity
  - Courts have also struck down agreements which prohibit employees from soliciting customers with whom the employee had no contact during his or her employment



# TYPES OF RESTRICTIVE COVENANTS

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# NON-COMPETITION

- Prohibits a former employee from working for a competitor in a specific position or line of business for a specific period of time in a specific geographic location
- Total restraint on ability to work is disfavored
- Less restrictive means are preferred by courts
- Consider:
  - Why would it be unfair for this employee to work for a competitor following his or her separation from employment? Draft the agreement accordingly
  - Present the agreement in an offer letter
  - Give employee time to review and consult with counsel
  - Consider coupling with severance pay

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## NON-SOLICITATION OF CUSTOMERS

- Prohibits an employee from soliciting your customers, vendors or suppliers during and after the employment relationship
- Consider limiting to customer with whom employee had contact or with whom employee possessed confidential information
- Consider a non-dealing clause for select customers, which restricts any contact for a competitive purpose

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## NON-SOLICITATION OF EMPLOYEES

- Prohibits an employee from soliciting your employees during and after the employment relationship
- Courts routinely enforce for limited periods of time

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## NON-DISCLOSURE

- Agreements that define what information is confidential and prohibits employees from disclosing or using the information both during and after the employment relationship
- Routinely enforced
- No durational requirement

# OTHER DRAFTING CONSIDERATIONS

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## ADDITIONAL CLAUSES TO CONSIDER

- Choice of law
  - Law significantly varies by state
  - Must be some relationship between the state whose law is chosen and the agreement
- Choice of forum
  - Must have substantial relationship to the contract and to employment
  - Courts will consider expense and inconvenience to the employee
- Attorney fees
  - Consider limiting to payment in the event employer prevails
- Injunctive relief

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## ADDITIONAL CLAUSES TO CONSIDER

- Liquidated damages
  - Must be reasonably related to a reasonable estimate of just compensation for actual damages
- Forfeiture provisions
  - Must be based on payment or benefit that may be legally forfeited
- Return of documents
  - Require return of all business information, not just confidential business information
- At-will employment
- Integration clause



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## ADDITIONAL CLAUSES TO CONSIDER

- Assignment
- Severability
- Require employee to advise prospective employers
  - Helps ensure compliance
- Severance
  - Increased likelihood of enforceability
  - Helps ensure compliance

# ENFORCEMENT

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## WHEN AN EMPLOYEE SEPARATES

- Unless employee resigns, process should begin weeks/days in advance
- Examine information to which they had access
- Alert critical departments and people prior to departure
- Conduct an exit interview
  - If resignation, ask where employee is going
  - Review obligations
- Collect all company property
- Beware of integration clause in any separation agreement

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## AFTER SEPARATION

- Secure former employee's e-mail in-box and restore deleted e-mail within 90 days of termination
  - Determine whether customer information or other confidential information was downloaded, copied, or printed by the former employee
- Contact customers and vendors closely serviced by ex-employee to implement transition
- Monitor post-separation customer activity for the former employee's area to determine changes, cancellations, volume sales reductions, delayed services, non-renewals

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## IF VIOLATION IS FOUND OR SUSPECTED

- Negotiate or litigate?
- If negotiation, consider:
  - Involving new employer
  - Buying-out employee of non-compete
- If litigation, consider:
  - Cost
  - TRO? The trend is that unless there is a clear case of irreparable harm, an injunction will not issue

# DEFENSES

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# LEGAL DEFENSES

- Lack of consideration/inadequate consideration
- Not reasonably necessary
- Not reasonably limited
- Unclean hands
- Material breach of contract
- Laches
- Selective enforcement

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# COUNTERCLAIMS

- Breach of contract
- Tortious interference with employment relationship
- Tortious interference with business relations
- Defamation



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# QUESTIONS?



# THANK YOU

Legal Disclaimer: This document is not intended to give legal advice. It is comprised of general information. Employers facing specific issues should seek the assistance of an attorney.

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**Ellen E. Hoepfner** is with the Labor & Employment Practice Group in Clark Hill's Detroit Office. Ellen represents employers in all aspects of employment law. She has defended employers in federal and state courts and before federal and state administrative agencies in matters involving employment discrimination, harassment, retaliatory discharge and wage and hour claims. Ellen also regularly counsels employers on personnel matters including: drafting employment and independent contractor agreements; drafting personnel policies and handbooks; completing and maintaining application, employment and Form I-9 records; managing leaves of absence, and; discipline and terminations. Ellen is also a sought-after corporate trainer and investigator for employers.

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Kurt A. Miller is with the Labor & Employment Practice Group in Clark Hill's Pittsburgh Office. Kurt's practice consists exclusively of the representation of management in labor and employment matters. He has defended employers against claims of sexual harassment, race, age, sex, national origin, and disability discrimination, violation of the FMLA, breach of employment contract, and wrongful discharge. He has represented numerous companies in the defense of wage-hour claims, including claims under the Fair Labor Standards Act and state wage-payment laws. He has also litigated, on behalf of employers and employee benefits plans, ERISA claims for alleged wrongful denial of benefits, breach of fiduciary duty, and interference with protected rights.

Kurt has prosecuted and defended all types of unfair competition litigation, including cases of alleged breach of non-competition and confidentiality agreements, misappropriation of trade secrets, breach of fiduciary duty, and trademark infringement.