

Protecting Your Client Base Through Effective Restrictive Covenants

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**NOT ALL RESTRICTIVE
COVENANTS ARE CREATED
EQUAL**

Step 1: What are you trying to protect?

► What is your “Legitimate Business Interest”?

- Customer Relationships
- Supplier Relationships
- Confidential Information
- Trade Secrets
- Workforce Stability
- Anything else?

**THE PROTECTION YOU SEEK
DICTATES THE BEST
METHOD TO USE**

Step 2: Identify the Best Method of Protection

► Covenant Not to Compete – Geographic Focus

- Must be reasonable in terms of time and geographic reach
 - ◆ Does not protect where geographic limitations are irrelevant
 - ◆ Do not rely on blue penciling
 - Ex: Court struck down as overbroad and oppressive restriction of employee “(x) within the metro area; (y) within 500 miles of the metro area; and (z) worldwide.”
 - » (x) alone may have been upheld
 - ◆ Must be narrowly tailored to the facts (job duties, information access, etc.)

Step 2: Identify the Best Method of Protection

► Covenant No to Compete

- Cannot restrict employment based on customer locations
- Employee agreed not to work for 2 years after termination “in any business that is engaged in any work or activity that involves a product, process, service or development on which I worked or with respect to which I had access to Confidential Information while with the Company anywhere the Company markets or sells any such product or service.”
- Held: “lack of a geographic limitation here renders the non-compete provision unenforceable without accompaniment by any specificity of limitation on the class with whom contact is limited.”
 - ◆ *Sigma-Aldrich Corp. v. Vikin*, 451 S.W.3d 767 (Mo. App. E.D. 2014)

Step 2: Identify the Best Method of Protection

▶ Non-Solicitation of Customers – Protection of Customer Base

- “The employee’s relationship with the client he owes to the employer, and he holds it in a kind of fiduciary capacity for the employer.”
 - ♦ *Property Tax Representatives, Inc. v. Chatam*, 891 S.W.2d 153 (Mo. App. W.D. 1995)
- Customer lists/contacts are legitimate business interests in most states
- Many customers are no longer geographically focused
- In *Chatam*, non-compete was deemed unenforceable because employee was terminated without good cause; non-solicitation may be enforced; remanded to determine if scope more extensive than reasonably necessary to protect legitimate business interests

Step 2: Identify the Best Method of Protection

▶ Non-Solicitation of Employees

- Protection of stable work force – Missouri Presumption – Mo. Rev. Stat. § 431.202.1

▶ Confidentiality and Non-Disclosure Agreement

- Protection of information that may not rise to the level of a trade secret
- Split among states whether claim for breach of confidentiality agreement is preempted by UTSA
- Contract shows efforts to protect trade secrets
 - ♦ Define clearly to keep confidential information and trade secrets separately protected
 - ♦ Impose specific requirements on return of documents/equipment and use upon termination

▶ Agreement governing ownership of IP

- Protection of innovations and developments

SPECIFICITY INCREASES ENFORCEABILITY

Step 3: Drafting with Specificity

- ▶ Identify the specific threat posed by the employee at issue
 - Duties and responsibilities
 - Is the employee the “face” of the company (e.g., sales)
 - What information is entrusted to the employee internally
 - What information will the employee develop through external connections
 - Does the employee have access to trade secrets
 - Will the employee be leading a “team”

Step 3: Drafting with Specificity

- ▶ Identify each state which may have an interest in the outcome
 - Enforcement differs from state to state – choose the best state that has an interest in the outcome
 - ◆ The employee’s residence
 - ◆ The company’s headquarters/satellite office
 - ◆ The company’s place of incorporation
 - ◆ The states serviced by the employee
 - ◆ If possible, draft to ensure protection in most conservative forum

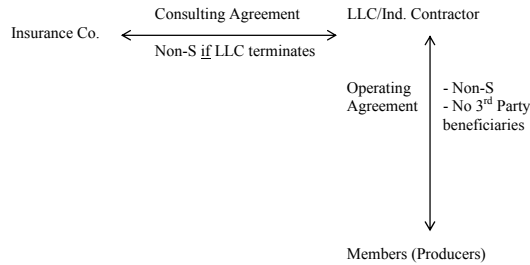
Step 3: Drafting with Specificity

- ▶ Narrowly Tailor Agreements
- ▶ One size does NOT fit all
- ▶ Getting greedy often renders covenants unenforceable
- ▶ Example of simple non-solicitation enforced in 1969:
 - Employee agreed “Upon the termination of his employment to deliver to the Company all lists of customers, samples, price lists and all other property belonging to the Company. For a period of one year from the termination of his employment not to directly or indirectly, as to products competitive to those sold by the Company, solicit or accept business from any of the Company’s customers that he had contact with in the territory he last serviced for the Company prior to the termination of his employment.”

Step 3: Drafting with Specificity



Bells and whistles may have unintended consequences



- Consulting Agreement did not address Member termination
- Operating Agreement did not expressly state Insurance Co. was 3rd party beneficiary / LLC had no protectable interest in insurance company's client base
- Neither company could enforce against departing member
- Issue with breadth of covenant not addressed

JTL Consulting, LLC, et al v. Shanahan, 190 S.W. 3d 389 (Mo. App. ED 2006)

Step 4: Ongoing Maintenance



Monitor and update agreements

- Each time a new compensation structure is implemented
- Each time the employee receives a promotion/changes positions/duties expand
- Each time an employee is transferred to another state
- Whenever necessary to ensure the agreement is narrowly tailored to meet the company's legitimate business needs given the employee's position

Conclusions

- ▶ There is no “one size fits all”
- ▶ Effective drafting requires consideration of
 - What you are protecting
 - The applicable jurisdiction
 - An understanding of the employee’s role in the company
- ▶ Narrow drafting increases the likelihood of enforcement
- ▶ Broad drafting decreases the likelihood of enforcement

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