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Back to Basics – SDNY Says Non-Competes Are Not Retention Agreements

Corporate counsel and human resource professionals may want to take a fresh look at their non-compete programs and the enforceability of their non-compete agreements – particularly as to high level executives. In a recent opinion from the U.S. District Court for the Southern District of New York, *IBM v. Visentin*, the Court denied IBM's request for a preliminary injunction to enforce the 12 month non-compete of a senior level executive. The executive had been hired away by Hewlett-Packard. In a 62 page opinion, the court took issue with a non-compete agreement and program which, in its words, was designed "not to protect…legitimate interests but to prevent…employees from taking employment elsewhere."

What Happened

In short, the Court rejected the general premise that a senior executive of one company should not go to work as a senior executive of a competing company. Where, as here, the Employer's concern was the inevitable disclosure of competitive information, the Court would not issue the injunction (and did not view the non-compete as likely enforceable) without evidence as to: 1) the specific confidential or trade secret information within the Executive's knowledge or possession that was being protected; and 2) the utility of that information in the Executive's new job. The Court, in reaching its decision, focused on the following:

- a number of the Employer's non-competes, including the one at issue, were form documents not subject to modification;
- the non-compete program included a financial "claw back" in the event of breach, which the court viewed as punitive and having no relation to a legitimate business interest;
- the Employer designed its non-competes to keep leadership from leaving, not to protect trade secrets;
- only some members of a corporate strategy team had a non-compete, and as such the Executive's participation did not in and of itself justify an injunction or enforcement of the non-compete;
- there was no evidence that the Executive misappropriated, or otherwise had knowledge of, any specific information that would be of value in his new job, was worthy of protection, or otherwise not protected; and
- the non-compete barred employment by any competitor regardless of the job.

Significantly, the Court was not persuaded by the non-compete's acknowledgement provision in which the Executive agreed his Employer would suffer irreparable harm in the event of breach, noting the lack of meaningful negotiation and the inability of parties to contract for injunctive relief where it would otherwise be inappropriate.

The Court also was not persuaded by the fact that the Executive would be paid for the duration of the restricted period. Rather, the Court found that being "sidelined" for a year would impose an undue hardship on the Executive's future employment prospects.

Moreover, while the Employer did not request a blue pencil revision of the non-compete, the Court saw no basis for partial enforcement given its rejection of what the Employer asserted as its legitimate business interest.

Key Points Worth Restating (aka, reminders from the SDNY)

1. **Non-Competes are valid only if they protect legitimate business interests.** In jurisdictions where non-compete agreements are permitted as to individual employees, protectable interests include trade secrets, confidential information and client relationships. Non-competes are not permitted to prevent ordinary competition or the departure of employees.
2. **Use the proper tool.** If the objective is to secure an enforceable non-compete, the terms must be clearly related to the protection of the business interest at issue. (For example, precluding an employee with access to a trade secret from performing the same job for a direct competitor.) If not, there are many mechanisms to retain top talent, including retention agreements, bonus plans, equity incentives, pensions and other forms of deferred compensation to name a few.

3. **Be vigilant and consistent in the protection of the stated business interests.** Courts may not enforce the non-compete if the business information at issue (for instance, pricing or product development) is not safeguarded or is otherwise publically known.
4. **Liquidated damages provisions may be appropriate in certain jurisdictions, but must be well defined.** Otherwise, financial penalties, or "claw backs" of economic incentives, may contribute to a determination of unenforceability if unrelated to the protection of the stated interest.
5. **Judicial revision of a non-compete agreement is not always available.** Some jurisdictions do permit the blue penciling, or partial enforcement, of otherwise unenforceable non-competes. One cannot assume, however, that a court will modify an otherwise unenforceable agreement.

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