COVENANTS – PINNACLE webxtra.doc

15A Sample Restrictive Covenant Provisions

This agreement is effective as of _____, 20___, between Acme Corporation and Jane Jones.

➢ ***Comment.*** Most restrictive covenants refer to the party to be bound simply as *Employee*. This practice imparts a mass-produced flavor to the agreement that suggests a contract of adhesion and does not further the employer's interest in enforcement. It makes sense for the employer to go to the small extra effort of referring to the employee by name throughout the agreement and making sure personal pronouns are gender-specific.

For the sake of illustration, the sample provisions suggested here assume an employment relationship between a hypothetical Acme Corporation and Jane Jones.

I. Purpose of Agreement

➢ ***Comment.*** The first step in drafting an enforceable restrictive covenant is understanding the employer's needs that justify the restriction. The two generally recognized justifications for restrictive covenants are customer contacts and access to confidential information. *See* Peter Albrecht et al., 3 *Wisconsin Employment Law* §§ 15.15–.18 (State Bar of Wisconsin PINNACLE 5th ed. 2013) (forthcoming). The next step is drafting a covenant carefully tailored to the employer's legitimate needs. The employer's needs should be stated and explained in the agreement itself to put the employee on notice of the reasons for the agreement and to establish a context for the restrictions that follow.

The following two alternative sample provisions address each of the possible justifications for the restrictions. In appropriate cases, the two may be combined.

[Choose appropriate alternative]

[Alternative 1: Customer-contact justification]

Acme and Jones have entered into an agreement by which Jones (is/will become) an Acme employee terminable at will. That employment will involve efforts by Jones to sell Acme's products, which will include personally contacting current and potential customers, seeking to engender customers' confidence in and reliance on Jones's skill and expertise, attempting to develop relationships of trust with customers, and otherwise promoting and utilizing the goodwill Acme has established with its customers and in the industry in general, all with the help and assistance of Acme.

Acme would not be willing to allow its goodwill to become identified with Jones, or to support Jones's efforts to develop personal relationships with Acme customers, without the assurance of reasonable protection against any attempt by Jones to exploit the company's goodwill and the relationships Jones develops with Acme customers in a manner that is inconsistent with Acme's best interests.

➢ ***Comment.*** The normal employment relationship is at will. *See* 1 *Wisconsin Employment Law* §§ 1.25–.33 (employment-at-will doctrine). However, since it is possible for courts to find express or implied contracts overriding at-will relationships arising out of a wide range of

sources, it is helpful from the employer's perspective to state the at-will nature of the relationship in any employment agreement.

The provision should spell out in as much detail as possible the different ways in which the employee may be able to capitalize on the employer's goodwill.

[Or]

[Alternative 2: Confidential information justification]

Jones's work requires access to *(list types of confidential information, e.g., customer lists, sales and other financial records, quotation files, billing files, customer files, correspondence, information on suppliers, computer programs and printouts, projections, business plans, marketing strategies, product development files, formulas, production processes)* and other competitively sensitive sources of confidential information about Acme's business. This is valuable proprietary information belonging to Acme. Acme would not be willing to provide access to this information to Jones without the assurance of reasonable protection against any use of this information by Jones in a manner inconsistent with Acme's best interests.

➢ ***Comment.*** The drafter should have an understanding of the different types of confidential information to which the particular employee is likely to have access. To the extent possible, the different categories of information should be specifically identified in the agreement.

[Continue]

II. Consideration

By signing this agreement, Jones affirms that she is willing to accept the restrictions this agreement imposes as a condition both of obtaining employment with Acme and of keeping that employment. Acme affirms that it requires Jones to sign this agreement as a condition of employment with Acme.

➢ ***Comment.*** See 3 *Wisconsin Employment Law* § 15.35 for a discussion of consideration for restrictive covenants.

III. Duration of Restriction

The restriction set out in the following paragraph shall remain in force for *(specify duration, e.g., two years)* after Jones's employment with Acme ends for any reason.

➢ ***Comment.*** The considerations relevant to the appropriate duration of a restrictive covenant are discussed in 3 *Wisconsin Employment Law* §§ 15.19–.22. As a practical matter, these considerations probably make the question of duration more complicated than it needs to be. In the vast majority of cases, the restriction should probably last at least one year but no longer than two years after the employment ends. A restriction lasting less than a year is unlikely to afford sufficient protection to justify the expense of enforcement. A restriction lasting longer than two years is likely to be struck down as excessive. *See* 3 *Wisconsin Employment Law* § 15.16. If the principal purpose of the covenant is to discourage an employee from being hired away by a competitor, a one-year restriction is probably long enough.

IV. Territorial and Activity Restriction

➢ ***Comment.*** The territorial and activity restriction, *see* 3 *Wisconsin Employment Law* §§ 15.23–.26, should be carefully crafted in light of the particular need of the employer that justifies the restraint. In general, there are five possibilities: (1) a restriction premised on customer contacts by which the employee calls on customers in a discrete and limited territory; (2) a restriction based on customer contacts, when the employee's customers are not limited to a single geographic territory; (3) a restriction based on identification with the employer's goodwill, when the employee serves a considerable number of customers or clients from a particular location and the employer depends on repeat business and referrals; (4) a restriction based on access to confidential information regarding customers; and (5) a restriction based on access to other confidential information. The following five alternative sample provisions address each of these possibilities.

[Choose appropriate alternative]

[Alternative 1: Customer contacts, specific territory]

Jones agrees that she shall not be involved in any fashion, directly or indirectly, in sales or attempted sales of products then sold by Acme, or products competitive with products then sold by Acme, to any purchaser or potential purchaser located in the geographic area for which Jones was responsible at any time during the year preceding the end of her employment with Acme.

➢ ***Comment.*** If the employer is a large, diversified firm, care should be taken to limit the activity restriction to the employee's actual responsibilities. *See Nalco Chem. Co. v. Hydro Techs., Inc.*, 984 F.2d 801 (7th Cir. 1993). The territorial restriction should be described in general terms such that it can encompass changes over time. It is inadvisable to describe a geographic territory in metes and bounds.

[Or]

[Alternative 2: Customer contacts, no specific territory]

Jones agrees that she shall not be involved in any fashion, directly or indirectly, in sales or attempted sales of products then sold by Acme, or products competitive with products then sold by Acme, to any present or former Acme customer for whom Jones was responsible at any time during the year preceding the end of her employment with Acme.

[Or]

[Alternative 3: Customer contacts at specific location]

Jones agrees that she shall not, directly or indirectly, compete with or engage in the type of business conducted by Acme anywhere within a *(specify number)*-mile radius of Acme's office at 1234 Main Street, Anytown, Wisconsin.

➢ ***Comment.*** The third type of territorial and activity restriction is appropriate when the employee serves a considerable number of customers or clients from a particular location and the employer relies on referrals. This type of restriction is frequently used in the medical field. *See* 3 *Wisconsin Employment Law* § 15.30.

The size of the geographic territory covered by the restraint depends on the size of the market served by the location in question. The affected territory should not exceed the area from which the bulk of the employer's business comes. *See* 3 *Wisconsin Employment Law* § 15.21.

The restriction should be drafted carefully so that it only prohibits the type of activities in which the employee was engaged on the employer's behalf. In *Geocaris v. Surgical Consultants, Ltd.*, 100 Wis. 2d 387, 302 N.W.2d 76 (Ct. App. 1981), the court struck down a covenant that prohibited the ex-employee from practicing as a physician in Brown County for nine months following the termination of employment. Since the employer's practice was limited to surgery, it was not entitled to impose the broader prohibition on practicing as a physician.

[Or]

[Alternative 4: Access to confidential customer information]

Jones agrees that she shall not be involved in any fashion, directly or indirectly, in sales or attempted sales of products then sold by Acme, or products competitive with products then sold by Acme, to any purchaser or potential purchaser that was a customer of Acme at any time during the year preceding the end of Jones's employment with Acme.

- ***Comment.*** A similar restriction was considered in *Rollins Burdick Hunter, Inc. v. Hamilton*, 101 Wis. 2d 460, 304 N.W.2d 752 (1981). The court held that whether such a restriction was reasonable depended on the totality of the circumstances. *See* 3 *Wisconsin Employment Law* § 15.22.

[Or]

[Alternative 5: Access to other confidential information]

Jones agrees that she shall not accept employment with or render services on behalf of a competitor of Acme or any other third party, in any capacity in which the confidential information of Acme acquired by Jones during her employment would reasonably be considered useful to the competitor or would enable the other third party to become a competitor of Acme.

- ***Comment.*** A restriction along the lines of the fifth alternative was held enforceable in *Brunswick Corp. v. Jones*, 784 F.2d 271 (7th Cir. 1986). Generally, this broad type of restriction may only be imposed on employees with substantial responsibilities and access to a significant amount of confidential and competitively sensitive information.

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V. Waiver of Unintended Effects

It is not the purpose of this agreement to preclude Jones from accepting employment or providing services that do not pose a competitive threat to Acme, if the possibility of such employment or services is brought to the attention of Acme in writing. If Jones wishes to engage in a business that may involve a violation of the terms of this agreement but Jones believes the business will not pose a competitive threat to Acme, Jones agrees to submit to Acme in writing a request to engage in the business. Any such request must specifically refer to this agreement. Acme agrees that it will respond to the request and that it will not unreasonably withhold permission to engage in the business specified in the request, regardless of the terms of this agreement, if the business sought to be engaged in does not pose a competitive threat to Acme.

➢ ***Comment.*** Restrictive covenants are nearly always drafted in the dark. They are frequently entered into at the outset of employment, but become effective only when employment ends. Circumstances may change substantially in the interim, which may provide the opportunity for the employee to argue that the provision's terms would prohibit a number of employment opportunities that pose no realistic competitive threat to the employer. *See* 3 *Wisconsin Employment Law* § 15.34 (discussing overbreadth defense). This type of provision attempts to accommodate the possibility of changing conditions and supply evidence of the employer's good faith. In addition, the provision puts the burden on the employee to seek the waiver. If the employee fails to do so, he or she will be in a poorer position to argue later that the covenant is overly broad.

There is no Wisconsin case law dealing with a provision of this sort. However, in a widely cited article, one commentator recommends that if an employer is willing to waive enforcement of a restrictive covenant when circumstances warrant, it should consider "spelling out in the contract the considerations taken into account and the procedure for securing waiver." Harlan M. Blake, *Employee Agreements Not to Compete*, 73 Harv. L. Rev. 625, 689 (1960).

VI. Nondisclosure Agreement

Jones acknowledges that the information contained in Acme's *(specify location of confidential information, e.g., customer files, correspondence files, quotation files, billing records, marketing plans, business projections)* and other business records constitute valuable and confidential proprietary information belonging to Acme. Jones agrees that she shall not at any time, while employed at Acme or for *(specify duration, e.g., two years)* after employment ends, disclose to non-Acme personnel or use for non-Acme purposes any such information belonging to Acme.

Jones also agrees that when her employment with Acme ends, she shall turn over to Acme all Acme documents in her possession, as well as all copies, summaries, and other materials that reflect any part of the contents of these documents.

➢ ***Comment.*** The various repositories of the employer's confidential information should be spelled out in the agreement to the extent possible.

See 3 *Wisconsin Employment Law* § 15.86 for a discussion of time limits in nondisclosure agreements.

As discussed in 3 *Wisconsin Employment Law* § 15.86, the existence of a nondisclosure agreement can bolster a claim for trade secret status for the affected information.

The surrender-of-documents provision can be a useful one for the employer. This obligation should be a topic of discussion at an exit interview. Although the provision may be difficult to enforce, it should impress upon the employee the nondisclosure obligation at the time he or she leaves employment.

VII. Assignment

This agreement shall accrue to the benefit of any successors in interest to the employer.

➢ ***Comment.*** This type of provision cuts off any possible argument by the employee that the restrictive covenant is part of a personal-services contract that may not be assigned without the employee's assent. *See* 3 *Wisconsin Employment Law* § 15.39 (ineffective-assignment defense).

VIII. Attorney Fees

If Acme substantially prevails in any legal action brought to enforce this agreement, Jones agrees to pay Acme its actual costs, including its actual attorney fees and all other costs of the litigation.

➢ ***Comment.*** This type of contractual fee-shifting provision is generally enforced. It can provide an effective deterrent for the ex-employee, for it creates potential liability in an undetermined amount. In many cases, this is the risk of violation that causes the ex-employee the most concern.

IX.Liquidated Damages

The parties acknowledge that it may be difficult to determine the amount by which Acme has been injured if Jones should violate the terms of this agreement. As a result, the parties agree that upon proof of a violation, Acme shall be entitled to damages of *(specify damages amount or how damages are to be calculated, e.g., "$ "; "$ per day of violation"; "an amount equal to Acme's sales revenues during the last full year for each customer whom Jones improperly solicits")*.

➢ ***Comment.*** The drafter of a restrictive covenant should pause before including a liquidated damages provision. Its inclusion may make it more difficult for the employer to obtain an injunction against a later violation. The absence of an adequate remedy at law is one of the elements of the showing required for an injunction. *See* 3 *Wisconsin Employment Law* § 15.42. The ex-employee can argue that the liquidated damages provision supplies the remedy at law and renders an injunction unnecessary. Also, there is the risk of setting the liquidated damages figure too low, such that violation of the restrictive covenant becomes an attractive option. The danger of overcompensating for this risk by setting the figure too high is that the provision will be struck down as punitive. *See* 3 *Wisconsin Employment Law* § 15.44.

➢ ***Final Note.*** A number of other provisions could be included in an agreement containing a restrictive covenant, including ones that address choice of law, modification and severability, arbitration, integration, and waiver, as well as a clause by which the employee acknowledges that the terms of the restrictive covenant will not keep him or her from gainful employment. Sources for such contractual provisions include: Kurt H. Decker, *Covenants Not to Compete: Forms, Tactics and the Law* (1993); Donald J. Aspelund & Joan E. Beckner, *Employee Noncompetition Law* (2012–13 ed.); and Michael J. Hutter, *Drafting Enforceable Employee Non-Competition Agreement to Protect Confidential Business Information*, 45 Alb. L. Rev. 311 (1981). In general, it seems that these types of provisions add little of substance, and their drawback is that they make the restrictive covenant a more intimidating document. Such clauses may also complicate enforceability. *See, e.g.*, *Beilfuss v. Huffy Corp.*, 2004 WI App 118, 274 Wis. 2d 500, 685 N.W.2d 373. The challenge for the drafter is not to anticipate and address all possible contingencies in the document, but to draft a restrictive covenant that protects the employer's legitimate interests in as simple and straightforward a manner as possible.