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CORPORATE LAW

Preventing Trade Secret Exposure By Former Employees

Drafting an enforceable corporate restrictive covenant

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As any employment practitioner is aware, the grant-ing of injunctive relief with respect to the enforcement of a restrictive covenant is far from automatic. Thus, it is critically important that the corporate practitioner draft a restrictive covenant to reflect the requirements set forth in New Jersey Law if there is to be any chance of later enforceability. Restrictive covenants with certain parameters, for example, between two and five years, and less than 20 miles are generally enforceable. Most others are generally too broad to be enforceable depending on the industry and circumstances.

Restrictive covenants now affect almost every phase of life in the business world. They are often linked to confidentiality, intellectual property and trade secret agreements, as well. Generally to be enforceable, restrictive covenants cannot be too restrictive. They cannot be so broad as to create a scintilla of doubt as to their enforceability. It is better to have a restrictive covenant of fewer years and a narrower geographic area, and have it enforceable, than to have a broader restrictive covenant which will not be upheld by the courts.

Even in the absence of a restrictive covenant, the New Jersey Common Law protects trade secrets and customer lists. The New Jersey Courts have long recognized that a business should be able to protect its trade secrets, confidential information and customer relations. The most recent New Jersey case on this issue is *Thomas & Betts Corporation v. Richards Manufacturing*, 2007 U.S. Dist. Lexis 31085 (D.N.J. 2007), decided by the District of New Jersey on April 26, 2007.

Thomas & Betts involved the Director of Engineering, Glenn Luzzi, of Elastimold, a division of *Thomas & Betts* who had executed a "Non Competition, Inventory and Secrecy Agreement" in 1978. Elastimold made specialty electrical connectors with the primary customer being Con Ed. It was discovered that Mr. Luzzi, who became employed by the defendant, had at his home 600 pages of Elastimold information.

The court cited the six elements a plaintiff must establish for a claim of misappropriation of trade secrets: 1) a trade secret exists; 2) the information comprising the trade secret was communicated in confidence by the plaintiff to the employee; 3) the secret information was disclosed by that employee and in breach of that confidence; 4) the secret information was acquired by a competitor with knowledge of the employee's breach of confidence; 5) the secret information was used by the competitor to the detriment of plaintiff; and 6) the plaintiff took precautions to maintain the secrecy of the trade secret. See also *Rycoline Products v. Walsh*, 334 N.J. Super. 62 (App. Div. 2000) (setting forth the six elements).

To determine whether a trade secret exists, New Jersey has adopted the definition set forth in the Restatement of Torts. "A trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business and which gives him an opportunity to obtain advantage over competitors who do not know or use it."

Thomas & Betts followed the traditional common-law New Jersey Supreme Court case of *Ingersoll Rand v. Ciavatta*, 110 N.J. 609 (1988), which notes six other supplementary considerations from the *Restatement* for the definition of a trade secret: (1) the extent to which the information is known outside of the business; (2) the extent to which it is known by employees and others involved in the business; (3) the extent of the measures taken by the owner to

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guard the secrecy of the information; (4) the value of the information to the business and to its competitors; (5) the amount of effort or money expended in developing the information; and (6) the ease or difficulty with which the information could be properly acquired or duplicated by others.

Thus, the corporate practitioner in drafting a Confidentiality Agreement/Restrictive Covenant should carefully take these elements into account, as well as their prospective enforceability in court. For example, in *Thomas & Betts* the court found numerous fact questions on the issue of whether a trade secret actually existed which precluded summary judgment.

In *Raven v. A. Klein & Co*., 195 N.J. Super. 209 (App. Div. 1984), the Court enforced a restrictive covenant in an employment agreement to the extent that it barred and enjoined employee's new company from manufacturing a similar type of box utilizing former employer's trade secrets. The Court further held that trade secrets constituted techniques which were unique to the plaintiff and not generally known throughout the industry. The Court opined that such trade secrets were protectable under the employment agreements and the common law.

Similarly, in *Sun Dial Corp. v. Rideout*, 16 N.J. 252 (1954), an action by a manufacturer of precision dials and panel against former employees along with their new corporation, the Court held that a valuable trade secret existed because although the individual components themselves may be well known, the plaintiff manufacturer's process, in its aggregate, was a trade secret because no other company was using it unless licensed by plaintiff and the process produced a superior product to that of competitors. Moreover, the Court found that a trade secret existed because the plaintiff made reasonable efforts to maintain the secrecy of the process, the process was not available to competitors or the public generally, and that the employees had learned the manufacturer's process in confidence.

Also, in *Heyden Chemical Corp. v. Burrell & Neidig*, 2 N.J. Super. 467 (App. Div. 1949), the court granted injunctive relief and held that plaintiff's processes were trade secrets and it was entitled to protection against disclosure or unauthorized use by defendant former employees.

Most important, customer lists are also protectable as "trade secrets." *AYR Composition, Inc. v. Rosenberg*, 261 N.J. Super. 495 (App. Div. 1993). A service company must obtain its customers at the "cost of time, trouble and expense in soliciting and obtaining them as customers" The names and addresses of a service company "are not open to and ascertainable by every one; they are the private information and property" of the service company. Additionally, the well-known New Jersey Supreme Court case of *LaMorte Burns & Co., Inc. v. Walters*, 167 N.J. 285 (2001), discusses the protectability of customer lists in the context of tortious interference claims.

The elements of enforceability of a general corporate restrictive covenant are the same as a medical restrictive covenant as outlined below. See *Maw v. Advanced Clinical Communications, Inc*., 179 N.J. 439 (2004). The public interest prong manifests the public's broad concern in fostering competition, creativity and ingenuity. However, we believe the Courts are more lenient in grant-ing enforceability to a restrictive covenant outside the medical context.

For example, in *Campbell Soup v. Desatnick*, 58 F. Supp. 2d 477, 489 (D.N.J. 1999), the court upheld a world-wide restrictive covenant for a critical executive at the Campbell Soup Company. A key marketing executive at Campbell attempted to take a new marketing position with a competitor, Pillsbury. The advent of the use of the Internet in the employment context will certainly expand the scope of geographic enforceability; but even it has some limitations. Therefore, we would caution drafters to work closely to understand the significance of restrictive covenants in their industry and draft conservatively on that basis.

A great deal of the cases dealing with restrictive covenants appear in the context of medical practices, which have long provided great guidance in drafting restrictive covenants. Most recently, on April 5, 2005, the New Jersey Supreme Court decided the case of *The Community Hospital Group v. More*, 183 N.J. 36 (2005). In that case, the New Jersey Supreme Court performed a detailed analysis of the enforceability of restrictive covenants in general and in the health care context.

Community Hospital Group, involved a restrictive covenant between a hospital and a physician. Community Hospital Group is better known as JFK Hospital in Edison, where the New Jersey Neuroscience Institute is located. In July 1995, Dr. More entered into an employment agreement with the Institute as a neurosurgeon and then a five-year agreement beginning in July 1999. The 1999 agreement contained a restrictive covenant that prohibited Dr. More from employment as a physician for a period of two years after leaving JFK Hospital within a 30-mile radius.

On July 17, 2001, Dr. More gave the Institute one year's notice that he would be leaving on July 17, 2002. Despite receiving offers of employment outside of the 30-mile radius, Dr. More on July 22, 2002, began employment with a neurological group in Plainfield, and obtained staff privileges at Somerset Medical Center approximately 13.5 miles from JFK.

One of the principal interest concerns of the Court is the "public interest." The Courts have long held that individuals have the right to have the doctor of their choosing to take care of them. Therefore, courts are quite reluctant to grant restrictive covenants that will keep patients from having the doctor who has been treating them continue to treat them, even if such practice would on its face violate a restrictive covenant.

It was in the "public interest" prong that the subject restrictive covenant failed. The Court found overwhelming evidence that Dr. More's services were irreplaceable in Somerset County as a neurosurgeon and that his services were highly in demand. To make matters worse for the Hospital, the Court found that because the two years had expired during the pendency of the litigation, the Hospital's request for injunctive relief is now moot.

In view of the *Community Hospital* case, it is quite apparent that it is critical for a drafter of restrictive covenants, whether in a medical or business context, to draft a restrictive covenant prudently so that it is consonant with prevailing law. Clearly, drafters have to match and tailor the requirements of their restrictive covenants to their own industry, but more importantly to be compatible with the law. It is clear that if a restrictive covenant is too broad (contains too large a geographical area), or too long (for too many years) given the industry involved, a court might be inclined to strike it down. Courts generally don't like to restrict the flow of commerce and only do so when it is clear that the parties seeking to enforce the restrictive covenant will be harmed more than the parties controlled by the restrictive covenant if the restrictive covenant is not upheld.

The courts will not eviscerate or avoid upholding a restrictive covenant, but the covenants must be drafted carefully, with a scalpel, so that they meet the requirements and realities of your industry. The courts are quite predisposed to protect intellectual property and trade secrets, including but not limited to "customer lists," and therefore will certainly protect the owners of businesses where appropriate. However, courts balance this interest against the free flow of commerce to come up with meaningful parameters for the creation of restrictive covenants. In a nut shell, it is better to be smart than harsh when drafting restrictive covenants so that they are upheld and fully comprehensible. The geographic limitations set forth in a restrictive covenant certainly have to be specific to an industry. For example, for a doctor 30 miles may be too much. However, for a salesman in a certain type of business, a restrictive covenant concerning several states or geographical areas may be acceptable as long as they would last for a reasonable period of time, i.e., two to three years.

One of the threshold questions before the Court was whether as a matter of public policy the Court should ban medical restrictive covenants at all. In the seminal case of *Karlin v. Weinberg*, 77 N.J. 408 (1978), the New Jersey Supreme Court upheld the enforceability of medical restrictive covenants provided they met a three-part test: 1) whether the covenant protects the legitimate interests of the employer; 2) whether the covenant imposes undue hardship on the employee; and 3) whether the covenant is injurious to the public or the public interest.

This three-part test was an extension of general restrictive covenant law as set forth in *Solari Industries, Inc. v. Malady*, 55 N.J. 571 (1970) and *Whitmyer Bros., Inc. v. Doyle,* 58 N.J. 25 (1971).

The Court in *Community Hospital* declined the invitation to overturn *Karlin*, finding that the employer had a legitimate protectable interest and indeed that the covenant would present no undue hardship on the employee. The court stated that the two-year time frame was reasonable, but questioned the reasonableness of a 30-mile radius.

The critical lesson for the corporate practitioner is to carefully and narrowly draft the restrictive covenant to specifically match and tailor the requirements set forth in the case law. Otherwise, the end result will be a restrictive covenant that is simply not readily enforceable, and thus restrictive at all. ■