

IN PRACTICE

## EMPLOYMENT LAW

### Restrictive Covenants for the Contemporary Employer

Must be personally drafted for each unique enterprise

BY MICHAEL HOFFMAN

With advancements in technology, businesses must now actively protect trade secrets and other intellectual property. An employer must position itself properly vis-à-vis employees who will more than likely someday leave to compete with it. Through a restrictive covenant, an employer may successfully claim unfair competition or misappropriation of proprietary information against a former employee.

#### The Restrictive Covenant

This covenant, upon termination of employment, restricts a former employee from performing similar work for another employer for a specific period of time and within a certain geographical area. The enforceability of a restrictive covenant depends upon its reasonableness. Pursuant to the seminal cases of *Whitmyer Bros. v. Doyle*, 58 N.J. 25 (1971), and *Solari Industries, Inc. v. Malady*, 55 N.J. 571

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(1970), a three-part test applies for the determination of reasonableness. First, the covenant must be no more restrictive than is necessary to protect the legitimate interests of the employer. Next, it must impose no undue hardship on the employee. Finally, the covenant must not be injurious to the public interest. In applying this test, interests of the former employer and employee are balanced and such factors as the position of the employee, the nature and scope of the restriction, and the type of potential injury involved will be considered. Accordingly, this test is fact sensitive.

A restrictive covenant is a "business tool" just as litigation may be part of a "business plan." An employer should meticulously identify its trade secrets and proprietary information and consider memorializing them in the text of the restrictive covenant.

#### Client Relationships

An employer has a legitimate interest in protecting its client/customer relationships. Thus, information subject to protection by a restrictive covenant need not necessarily rise

to the level of the usual trade secret. Indeed, information may otherwise be public yet, nevertheless protectable per a restrictive covenant. Again, the fact that information may be available from public sources does not mean the information is not confidential as between an employer and others. For example, client buying habits, mark-up structures, business or marketing plans, sales projections and product strategies flow from public clients but, nonetheless constitute confidential information. Further, an employer may protect its client relationships even if not exclusive. An employer has a legitimate interest in protecting client relationships particularly where an employee has personal relationships with those clients.

The propriety of client information should be addressed within the restrictive covenant. For the law protecting "client relationships," counsel should review the decisions in *A. T. Hudson & Co. v. Donovan*, 216 N.J. Super. 426 (App. Div. 1987), and *Platinum Management, Inc. v. Dahms*, 285 N.J. Super. 274 (Law Div. 1995).

#### Trade Secrets

More particularly, a business certainly has a legitimate interest in protecting trade secrets. A trade secret may consist of a pattern, process, device, formula, or compilation of information (including even a list of customers) so long as this information

gives the employer an advantage over competitors that do not know or use this information. To determine whether information constitutes a trade secret, a court may consider: (1) the value of the information to the employer and its competitors; (2) the effort or resources expended in developing it; (3) the extent to which it is known outside of the industry; (4) the extent to which it is known by those involved in the business; (5) the efforts made to protect it from disclosure; and (6) the ease with which others may acquire or duplicate the information. A trade secret need not be patentable or even novel. Complete secrecy is not required. Similarly, where through the course of business the employer has compiled information regarding the particular needs or preferences of its clients, and has attempted to protect that information from disclosure, the information may be protectable as a trade secret even though the identity of clients may otherwise be common knowledge. Pricing information and specific business plans or marketing strategies may also be protectable under certain circumstances. For a thorough understanding of the ambit of "trade secrets," counsel should review the decisions in *Ingersoll and Co. v. Ciavatta*, 110 N.J. 609 (1988), *Sun Dial Corp. v. Rideout*, 16 N.J. 252 (1954), and *Rycoline Products, Inc. v. Walsh*, 334 N.J. Super. 62 (App. Div. 2000).

Accordingly, it is important to consider identifying trade secrets within the body of a restrictive covenant. As a court will consider the efforts to protect such designated information, a restrictive covenant should recite those efforts as well. An employee should acknowledge within the restrictive covenant that the identified information is in fact secret or proprietary and securely maintained.

#### **Software Concerns: Coding and Copyright**

Technology now empowers even small companies to develop proprietary software for internal business purposes as well as purchase. Consequently, such businesses must now

concern themselves with protecting software "source" and "object" code from employee piracy. In this context, counsel should review the decision in *Whelan Associates v. Jaslow Dental Laboratory*, 797 F.2d 1222 (3d Cir. 1986), for a lawyerly discussion of software development and coding. Again, an employee within the restrictive covenant should acknowledge that the coding process is in fact proprietary and, moreover, that the entire process of writing a computer program, inclusive of development of the structure and logic of the program, debugging, documentation and maintenance, are proprietary and a matter of trade secret.

As a practical matter, it may be recommendable in certain instances to subject versions of coding to contemporaneous, historical "hash analysis" and to preserve that analysis for later use in prosecuting a misappropriation claim. MD5 hash values are a unique electronic or digital fingerprint of an electronic document created by the application of an algorithm. See *Bro-Tech Corporation v. Thermax, Inc.*, 2008 WL 724627 (E.D.Pa.); *Paramount Pictures Corp.*, 2006 WL 2092581 (E.D.Pa.); *United States of America v. Eberle*, 2006 WL 1705143 (W.D.Pa.); *United States v. Heiser*, 2006 WL 1149254 (M.D.Pa.). A real-time hash analysis of coding may be the preferred form of data for a forensic analysis. At a minimum, such effort at the time of creation will help demonstrate the proprietary treatment of code during creation rather than solely consequent to subsequent litigation with a former employee.

Further, it is important to note that a software program is subject to copyright protection even if not previously registered. Registration of a copyright is only a requirement for filing an infringement action and, moreover, upon registration, such a suit may encompass claims of infringement occurring preregistration. See 17 U.S.C.A. Section 411. Also, copyright not only extends to the literal elements of a computer program, but also to non-literal elements towards the distinction

between idea and expression. This protection thus encompasses the look and feel of the nonliteral elements of a computer program, for example, screen displays, obvious portions of user interface, required keystrokes for operation and use of functions of the program. Here, counsel should review the influential decision in *Apple Computer, Inc. v. Franklin Computer Corp.*, 714 F.2d 1240 (3d Cir. 1983). Again, an employee within the restrictive covenant should acknowledge such potential for an employer's copyright in a software program. These acknowledgments and such effort should be memorialized in the covenant.

#### **Holdover Provisions**

A business may protect information that does not neatly classify as a "trade secret" or rise to the level of "property." To this end, an employer may include a holdover provision within a restrictive covenant. This holdover essentially obliges a former employee to assign to the employer all rights in any development created within a certain time period post-employment so long as that development was conceived as a result of, or at least attributable to, work undertaken during employment. Such a provision, as judicially enforced, recognizes that an employer who invests to establish a workplace atmosphere empowering employees to freely gather and exchange information should acquire an equity interest in the post-employment use of that information even if that use would not otherwise be protected. This "information" is neither a trade secret nor proprietary, but, rather, characterized as highly specialized, current information not generally known in industry, created and stimulated by the research environment furnished by an employer, to which the (former) employee has been exposed and enriched solely due to his employment. In this regard, counsel should review *Ingersoll-Rand Co. v. Ciavatta*, 110 N.J. 609, 638 (1988). Particularly in highly specialized development enterprises, a holdover provision should

be part and parcel of a restrictive covenant.

### **Conclusion**

The days of generic restrictive covenants are gone. A restrictive covenant for the modern-day business plan

must be personally drafted for each unique enterprise. This covenant should identify and list asserted trade secrets and proprietary information and should recite those efforts, aside from the restrictive covenant itself, engaged in to develop and protect that information. While under judicial scrutiny a particu-

lar provision of a restrictive covenant may ultimately be deemed unreasonable or a certain piece of information may be determined not to constitute a trade secret or property, a restrictive covenant nevertheless serves as a deterrent for the soon to be competitor, former employee. ■