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Labor: 3 factors to consider when litigating covenants not to compete

Noncompete lawsuits will protect business interests, if used properly.

By Craig Oliver

Covenants not to compete, or "noncompetes," are commonplace in the employment context. Although state laws affect the validity of particular restrictions, the widespread notion that courts never enforce noncompetes is misplaced. Courts frequently enforce reasonable restrictive covenants that are narrowly tailored to protect legitimate business interests.

This is not to say, however, that an employer should rush to the courthouse whenever it believes a former employee is violating a noncompete. Employers that file noncompete-related lawsuits based on emotion, rather than a calculation of the costs and benefits of various courses of action, often find themselves deep into a lawsuit with nothing to show for it but increased legal expenses.

Three factors an employer should consider before filing a lawsuit based upon a noncompete violation are examined below:

1. Is a lawsuit the best means of accomplishing the desired outcome?

Undoubtedly, there are benefits to bringing a lawsuit when a former employee is violating a noncompete. The lawsuit may have a deterrent effect, both on the former employee who is violating the noncompete and on other current and former employees who are aware of the ex-employee's actions. Further, if the former employee is using information the employer deems confidential, a lawsuit provides a means of protecting the confidential nature of such information.

If the employer does not take steps to protect its confidential information, the information may lose its protected status. Additionally, although it may be difficult to calculate damages caused by the breach of a noncompete, a lawsuit allows the employer to seek monetary damages.

A lawsuit may not be the best means of achieving the employer's goals, though. If the employer loses the lawsuit, in whole or in part, current and former employees may see an opportunity to exploit the situation before the employer can correct any flaws in the noncompete that become known through litigation. Further, the costs of litigation are high, in terms of legal expenses and potentially impaired client relationships.

Often, the best witnesses in noncompete cases are clients, and employers are understandably reluctant to require their clients to testify at depositions or trial. Moreover, in many cases a noncompete dispute is not only between an employer and its former employee, but also involves the former employee's new employer. That employer likely has noncompetes with its employees.

This dynamic leads to the potential for an agreement between the employers that will satisfy both, including perhaps giving the "aggrieved" employer something that it could not get at trial (e.g., a longer "nonsolicit" term in exchange for an agreement that the former employee may work for the new employer).

2. Should the employer seek preliminary relief?

Assume that an employer has decided a lawsuit is the best course of action. The employer must decide if it will seek a temporary restraining order or temporary injunction. Possible benefits of such an action include ending competition that may be conspicuous to other current and former employees, and acting to protect the employer's client base and/or confidential information before damage occurs that cannot be undone.

On the other hand, obtaining preliminary relief is not as easy as is commonly assumed. In most situations and jurisdictions, courts consider a variety of factors in addition to whether the employer is ultimately likely to succeed on the merits. For example, many courts consider whether monetary damages can provide an adequate remedy to the employer. Recently, given the state of the economy, courts have become reluctant to order individuals to leave an established job and, instead, have increasingly found that monetary damages can adequately address harm sustained by an employer.

The denial of an employer's request for preliminary relief can be misperceived as a "victory on the merits" for the former employee, creating problems for the employer. Thus, absent the impending loss of a major client or disclosure of highly confidential information, many employers have begun filing a lawsuit for breach of a noncompete without seeking preliminary relief.

3. How many defendants should there be?

As mentioned above, the former employee's new employer frequently finds itself in the middle of a noncompete dispute. Because the new employer may have "deeper pockets" than the former employee, and because many jurisdictions allow the recovery of heightened damages from new employers that induce a breach of a noncompete, there are benefits to naming the new employer as a defendant. The addition of the new employer may facilitate resolution of the lawsuit, too.

However, on occasion it may be wise to pursue a "divide and conquer" strategy and bring a lawsuit against only the former employee. Through discussions with the former employee's new employer, or otherwise, the employer may surmise that the new employer is not fully committed to the employee. If only the former employee is sued, the new employer may not pay the legal expenses of the employee, and may even terminate that individual's employment (at least until the noncompete dispute is resolved).

And, if the lawsuit proceeds without the direct involvement of the new employer, the employer may obtain evidence from its former employee that will establish an inducement claim against the new employer and support adding the new employer as a defendant later, when it is too late for the employee and the new employer to "get their stories straight." ■

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