

# Arizona Update & Multi-Jurisdictional Issues Involving Restrictive Covenants



MARY ELLEN SIMONSON  
LAURA PASQUALONE



# Overview



- **Brief Summary of Arizona Law Regarding Restrictive Covenants**
- **Multijurisdictional Issues**
- **Best Practices For:**
  - Drafting Restrictive Covenant Agreements
  - Exiting Employees
  - Hiring Employees Subject to Restrictive Covenants
- **Defend Trade Secrets Act**
  - Need to revise agreements to add notice provision under the DTSA

# Varieties of Restrictive Covenants



- **Noncompete covenants**
  - Prevents competitive employment within restricted area
- **Nonsolicitation covenants**
  - Hands-off agreement
  - Prevents solicitation of customers, suppliers, employees
- **Nondisclosure and confidentiality covenants**
  - Protects confidential information
  - Protects trade secrets

# General Requirements



- **Consideration**
- **Reasonable geographically (non-competes only)**
- **Reasonable in duration**
- **Not against public policy**
- **Limited to protection of employer's legitimate interests**
- **Reasonable under the circumstances**

# Legitimate Protectable interests



- Long-term business and customer relationships
- Goodwill
- Confidential Information
- Trade Secret Information
  
- **Illegitimate:** preventing competition!



# Non-Competition Provisions



- Less likely to be enforced, particularly in Arizona
- Closely scrutinized for reasonableness in terms of geography, time duration, and scope of prohibited activity
- Recent federal cases applying Arizona law have refused to enforce non-compete agreements where employees were already subject to confidentiality and non-solicit restrictions
  - *Unisource Worldwide, Inc. v. Swope*, 964 F. Supp. 2d 1050, 1065 (D. Ariz. 2013); *Or-Cal Inc. v. Tessengerlo Kerley Inc.*, No. CV-14-01980-PHX-DGC, 2015 WL 751212, at \*5 (D. Ariz. Feb. 23, 2015)

# Non-Solicitation Provisions



- More likely to be enforced
- Must be limited to the customers/employees with whom the employee had a relationship throughout course of employment
- Restriction must be limited to active current customers and current employees
- Cannot prevent the solicitation of former customers or prospective customers

# Non-Disclosure Agreements



- More readily enforced than other post-employment restrictions
- Must exclude publicly available information from definition of confidential information
- The more specific, the easier to enforce
- Should require the person/company to return the information upon demand or within a specific time after termination of the relationship
- Enhance and complement protections afforded under that AUTSA and DTSA



# Other Steps to Protect Confidential Info



- Highly sensitive documents should be marked “Confidential.”
- Limit access to confidential information on a need-to-know basis
- Security precautions (locks, passwords, badges, etc.)
- Control size of email attachments
- Electronic communications, social networking policies
- Immediately terminate access to confidential info when notice of termination of employment is provided

**CONFIDENTIAL**

# Blue Pencil Rule



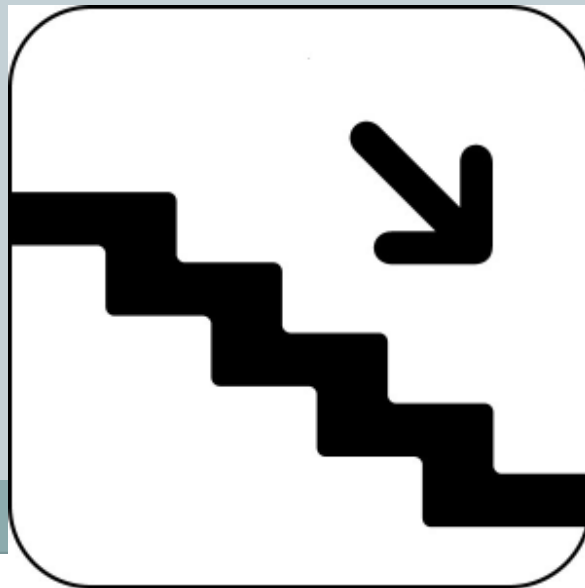
- Arizona courts will not re-write overbroad restrictions to make them enforceable
- Arizona courts will “blue pencil” (cross out) grammatically severable unreasonable provisions, leaving valid portions to be enforced



# Step Down Provisions



- Provide alternative geographical areas and durations, and even definitions of the competing activities, with the goal that at least one will be enforced
- *Compass Bank v. Hartley*, 430 F. Supp. 2d 973 (D. Ariz. 2006) - Judge Silver picked least restrictive option



# Multijurisdictional Issues



- Some states will enforce restrictive covenants. Others essentially do not enforce them at all
- Need to understand how the laws of the various states in which you do business view restrictive covenants and generally understand which laws are likely to apply to your agreements
- Employers cannot solely rely on choice of law and/or forum clauses
- Some states refuse to enforce choice of law/venue provisions
- Courts can reach different conclusions as to enforceability based on similar facts

# Choice of Law Rules



- Chosen law must not lack substantial relationship or be contrary to the public policy of the state with the materially greater interest
- Courts will consider: where the contract was entered, where the employer and employee are located
- *Pathway Med. Technologies, Inc. v. Nelson* (D. Ariz. Sept. 30, 2011)
  - Court refused to enforce Washington choice of law provision because Washington law would conflict with Arizona law and Arizona had materially greater interest. Washington law allows a court to rewrite overly broad agreements.

# Venue Selection Rules



- Venue selection must not be the product of overreaching, against public policy, unreasonable, or overly burdensome
- Wrong forum in state court can result in dismissal; in federal court you simply get transferred
- Often most important factor will be where lawsuit is filed or likely to be filed first – that state's venue rules will apply, and if the case stays in the same venue, that state's choice of law rules will apply

# Forks in the Road



- **Jurisdictions Where Non-Competes are Prohibited:**
  - CA (allowed for sale of business); ND; OK
- **Choice of Law provisions will not be enforced as an end-run around the prohibition**
- **These states will enforce reasonable non-solicits and NDAs**



# Forks in the Road (Cont'd)



- **Consideration**
  - At-will employment at inception - most common approach
  - Continued at-will employment
    - ✦ AZ, OH, NH, NY
  - Something more needed (promotion, bonus, stock options)
    - ✦ CT, MN, NC, OR, SC, VA, WA, WV, WI, TN
  - Special Rules
    - ✦ TX – requires disclosure of confidential information



# Forks in the Road (Cont'd)



- **Reformation**

- FL, OH, NJ, NY (now GA)

- **Blue Pencil**

- AZ, CO, CT, ID, IN, MD, LA (if K permits), NC, SC, WI

- **Red Pencil**

- NE, VA (formerly GA)

# Forks in the Road (Cont'd)



- **Customer Restrictions**
  - Only those with whom personally had contact
    - ✦ AZ, NY, MD, CA, TX
  - All customers of the company
    - ✦ OH
- **Length of Time**
  - Some states identify reasonable / unreasonable length of time
    - ✦ Ex: In Florida, 2 years is reasonable by statute

# Tips for Drafting Agreements



- Determine what needs to be protected, and from whom
- Determine which employees really need noncompetes or nonsolicitation provisions
- Consider whether a nonsolicitation provision or NDA will work just as well as a noncompete
- Consider what state law is likely to apply/be enforced
- Consider tailoring agreements based on where employee is located. Have agreements reviewed by attorneys familiar with the laws of the potentially applicable states.
  - Employment Law Alliance
- Consider whether goal is deterrent effect versus enforcement

# Other Practical Considerations



- What types of agreements do your competitors use?
- How long would it realistically take to replace the employee and have them establish goodwill with customers?
- Employers must be prepared to justify need for restrictions, including scope
- Make sure restrictions are appropriate to employee's particular position
- Consider goals of enforcement vs. deterrent effect
- Consider your options regarding attorney fee shifting provisions
- Store executed agreements somewhere safe

# Best Practices for Exiting Employees



- Remind departing employees about their restrictive covenant agreements (always in writing/attach it)
- Make good use of demand letters prior to litigation
- Maintain a consistent approach to enforcing agreements
- Immediately take steps to preserve hard drives and company-issued cellphone
- Review emails and other files after files have been preserved
- Consider putting new employer on notice of former employee's obligations; consider potential downsides too

# Best Practices for Exiting Employees (Cont'd)



- **Possible Sources of Evidence:**
  - Departed employee's computers
  - Company's server
  - Departed employee's voicemail
  - Departed employee's cell phone
  - Thumb drives
- **Take appropriate steps to retrieve and preserve**
  - Huge help to strengthen demand letters
  - Essential if litigation required

# Enforcing Noncompete or Trade Secret



- When demand letters don't work – realistic assessment of costs of litigation, impact, strategy
- Options:
  - Temporary Restraining Order
  - Permanent Injunctions
  - Declaratory Relief
  - Damages

# Hiring Candidates Who Have Signed Restrictive Covenants



## Best practices:

- Ask each serious candidate if they've signed a restrictive covenant agreement with prior employer
- Include a confirmation in employment agreement or offer letter
- Written warning/agreement not to bring anything
- Communications with supervisors about importance of not receiving/using/disclosing confidential information
- Training & Documentation—cannot emphasize too much!



# If the Employee is Subject to a Restrictive Covenant...



- Obtain a copy of the covenant and review to assess scope and enforceability
- Determine whether you can safely hire the employee and what the risks are
- Determine whether the candidate is worth the risk. Consider whether to sideline the candidate or restrict his/her activities for a period of time
- Give written instructions to the new employee, and as appropriate, his/her supervisors
- Consider whether to preemptively reach out to the current or former employer

# Defend Trade Secrets Act



- Creates a federal civil action for the owner of a trade secret who is “aggrieved by a misappropriation of a trade secret”
- The terms “trade secret” and “misappropriation” are intended to have the same basic definitions as the definitions that apply under the UTSA
- One of the goals: give plaintiffs access to federal courts, which are better equipped to handle cases of interstate or international misappropriation of trade secrets
- Unique feature: equitable remedies include expedited relief in the form of an *ex parte* seizure, but only in extreme circumstances so as to prevent further dissemination of trade secret information and/or for the preservation of evidence

# Defend Trade Secrets Act (Cont'd)



- Immunity provisions allow employees to avoid liability for the disclosure of a trade secret to a governmental official or to an attorney for the purpose of reporting or investigating a suspected violation of law or for use in an anti-retaliation lawsuit
- To be eligible to recover exemplary damages (up to double damages) and attorney's fees under the DTSA, an employer must provide notice of the employee immunity provisions
- Employer may either incorporate the immunity provisions in the NDA or include a cross-reference to the employer's whistle-blower policy containing the requisite immunity provisions
- The notice provision applies to contractors and consultants
- Applies to agreements entered into after the effective date of the DTSA (May 11, 2016)

# Questions?



**THANK YOU!**