CLIENT NOTE

PUTTING TOGETHER THE EMPLOYER PROTECTION PUZZLE: DO NEGATIVE COVENANTS ACTUALLY WORK?

Overview

Over the past few years, businesses involved in science and technology are facing increased pressure to come up with measures to protect their interests as employees are gaining more mobility and demand globally. This Note tries to lay out some of the options that employers may have in designing and enforcing "negative covenants".

Many companies that are carrying on their business in financial, engineering, IT sectors face the phenomenon called "employee theft", which in most cases results in reducing of companies' profits, demolishing potential perspectives of startups and thus endangering the latter's thriving future. In the past few years employers seek to find a remedy to prevent the "leak" of skillful labor from their business. Despite the "infinite inclination" of the employers to keep harmless and avoid any negative impacts on their business from their former employees, it should be noted, however, that this "desirable wish" shall not be discretionary and limitless. It is worth mentioning that this "restrictive mechanisms" must strike a fair balance between the legitimate interests of the employers and employees. Thus, this Note describes the main features and issues of enforceability of Non-Compete, Non-Solicitation and Non-Disclosure Covenants (hereinafter referred to as "Restrictive Covenants" or "Restrictive Clauses") in the Republic of Armenia.

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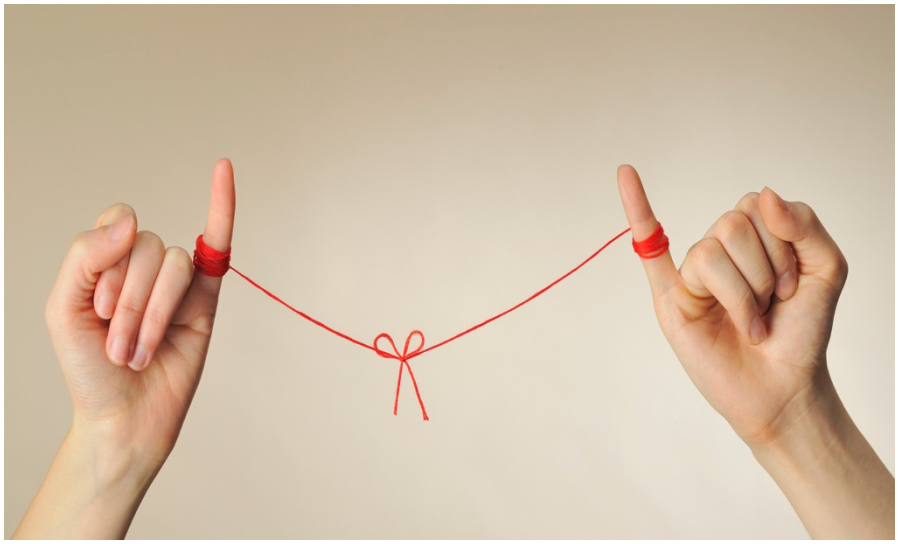

Non-Compete Agreements (also known as "covenant not to compete") are enforced when a labor relationship between an employer and employee[1] is terminated and the employer wishes to prevent the employee from competing against them in their next position or starting a new business or working for a competitor[2]. In simple words, employers usually rely on non-compete covenants because of the possibility that the employee may obtain an unjustified and illegal privileges by abusing trade secrets (business practices, customer or client lists, marketing plans, know-how, show-how) and other confidential information about their former employer.

Non-Solicitation Agreement is considered to be as a covenant according to which an employee is prohibited from soliciting a company's present or future clients or customers, for his/her own benefit or for the benefit of a competitor company, after the employee's departure from the company. As it is illustrated in court decisions of New York State: *"non-solicitation of employees or no-hire provisions prevent competitors from poaching employees with access to confidential information or from targeting employees with unique personal relationships with the employer's clients"*[3].

Non-Disclosure Agreement (or simply as an NDA or Confidentiality agreement), is a contract between two or more parties where the subject of the agreement is a promise that confidential or proprietary information transferred will be maintained in secrecy. By signifying the confidential relationships between the employer and the employee the parties furnish information with each other that is not accessible and should not be made available to any other parties, such as competitors or the public.

[1] It is worth mentioning that in some cases the foregoing covenant shall also be applicable to consultants and contractors.

[2] The Restrictive Covenants shall also be in force for the entire duration of employment.

[3] Master Card, 164 F. Supp. 3d at 602; Genesee Val. Trust, 130 A.D.3d at 1558.

Armenian law and possible solutions

The legislation of the Republic of Armenia does not stipulate any regulations with respect to determination and enforcement of the abovementioned covenants. In judicial practice, there is no specific evidence which will guide us on the scope of criteria that shall be applicable in relation with enforcement and validity of Restrictive Covenants.

However, it is worth mentioning that flexibility of the legislation of the Republic of Armenia allows us to find some possible solutions with respect to the foregoing issues. **First,** the labor legislation of RA does not include any **direct** prohibition in respect of Restrictive Covenants. **Second,** Article 6 (2) of the Labor Code envisages that if the labor legislation does not **directly** prohibit the parties from independently providing mutual rights and obligations on contractual basis, then in such situations the parties shall be governed **by the principles of fairness, reasonableness and honesty**. **Third,** one might take into consideration the best international practice, which has outlined some essential criteria that shall be considered to be cornerstones for the enforcement and validity of the Restrictive Covenants. Namely:

- **Existence of the legitimate interest of the employer.** In order to irrevocably enforce the Restrictive Clauses, the employer must demonstrate the legitimate and protectable interest (e.g. the customer relationship or good will of the employer, trade secrets, protecting the company from the mass departure of valuable employees with specialized skills, knowledge, and access to confidential information/trade secrets, protecting customer list of company, etc.).
- **Absence of undue hardship for employee.** This criterion shall be revealed using the standards of timing and geographical scope of the Restrictive Clauses taking into account the factors that the covenants shall not impose excessive burden and restrictions on an employee.
- **Timing/duration.** The duration of Restrictive Covenants must be reasonable, fair and honest. In other words, the shorter the agreement/covenant, the more likely a court is to find it enforceable.

- **Geographical scope**. A court is more likely to find the Restrictive Covenants enforceable if they apply only to a limited geographical region, in which competition would truly undermine the employer's business. How large an area is reasonable, fair and honest will be determined in case by case basis. The main idea is that "the area in which competition is to be restricted must not be broader than is necessary to protect the employer's interests"[4].
- **The way of termination of employment contract.** Restrictive Clauses are valid in cases of termination by the employee, under termination for cause by the employee, justified and legal termination for cause by the employer or termination by agreement (if not agreed otherwise).

How we can help?

Our team has extensive experience in providing carefully designed and drafted language in employment contracts to protect the vital interests of businesses. So do get in touch.

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[4] Partylite Gifts, Inc., v. MacMillan, C.A. No. 810-CV-1490-T-27EAJ.