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EMPLOYMENT LAW

Anti-Raiding Covenants

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Over the past decades, numerous courts have considered the use of noncompetition agreements in protecting employer interests in such areas as trade secrets and confidential information. There is, however, another form of restrictive covenant that employers are including in their employment agreements: nonrecruitment or anti-raiding covenants, which forbid former employees from enticing their erstwhile co-workers into leaving their employer to work for a competitor. Only a limited number of jurisdictions have addressed the validity of these covenants, and the conclusions range everywhere from absolute validity to near total prohibition.

In what appears to be the first state supreme court to address nonrecruitment covenants, the Georgia Supreme Court ruled emphatically 35 years ago, in *Harrison v. Sarah Coventry Inc.*, 228 Ga. 169 (1971), that nonrecruitment covenants were fully enforceable. Its reasoning was significant in that it determined that such restrictions were not "negative covenants in employment contracts." Georgia common law, which is perhaps the most hostile of any state to anti-competition covenants in employment agreements, defined a prohibited "negative covenant" to be an employment contract provision that commits the employee not to be employed in or engage in any business in competition with the former employer. Id. at 171. But nonrecruitment covenants, the Georgia court reasoned, do not forbid a former employee from practicing his or her trade; rather, the employee remains free to enter into the employment of a competitor, and has only entered into a valid contractual agreement "not to interfere with the contractual relationships of the [former employer] and its other employees." Because anti-raiding clauses are outside the domain of "negative covenants," they are, the *Harrison* court ruled, fully enforceable without the restrictions on time or geographical scope.

Several states have now adopted Georgia's approach

The Georgia approach is followed in several states, even some that have statutory bans on noncompetition clauses in employment agreements. For example, in Texas such noncompetition agreements are prohibited by its statute that declares as contrary to public policy and unlawful every "contract, combination or conspiracy" that is "in restraint of trade or commerce." Yet the prevailing view in Texas is that nonrecruitment clauses are not a "restraint on trade" and, therefore, not subject to the statutory ban. See *Banker Petrolife Corp. v. Spicer*, No. 06-1749, 2006 WL 1751786, at *4 (S.D. Texas June 20, 2006).

The same result was reached in California, which is well-known for its statutory ban on noncompetition agreements in the employment context. Nonetheless, in *Loral Corp. v. Moyes*, 174 Cal. App. 3d 268, 275-80 (1985), an intermediate appellate court declared that nonrecruitment covenants were lawful.

The *Loral* court, like the Texas decision in *Spicer*, drew an analogy between anti-raiding clauses and nondisclosure agreements, and it concluded that these did not run afoul of the statutory ban on restraints of trade. More significantly, it ruled that a provision preventing a former employee from damaging or interfering with his former employer "by raiding [its] employees" was not a "significant" restraint on his ability to engage in his own profession, trade or business.

In coming to this conclusion, the *Loral* court presumed that the restriction in the case was warranted to "maintain a stable work force and enable the employer to remain in the business." The court also noted that the restriction "only

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slightly affects" the former co-workers, as they are not restricted from seeking employment at the same company as their former colleague or contacting him about prospects of joining him at his new employer. "All they lose," the court reasoned, "is the option of being contacted by him first."

Some courts are picking up on what the *Loral* decision presumed and are explicitly holding that employers have a legitimate, legally cognizable interest in protecting their investment in the training they provide to their employees. For example, in *Balasco v. Gulf Auto Holding, Inc.*, 707 So. 2d 858, 860 (Fla. 2d Dist. Ct. App. 1998), one Florida court ruled that the employer had a legitimate interest in "the substantial investment [it] makes in specialized training for its staff." The court conducted a detailed review of the high amount of training the employer provided and noted that "raw recruits" could take up to six months to develop, causing substantial harm to the employer in the event trained employees were lured away and new recruits were necessary. It remains uncertain, though, how "substantial" an employer's investment must be in order for a nonrecruitment agreement to be enforceable.

The volatility in this area of the law is illustrated by a series of cases in Illinois. One state appellate court decision upheld a nonrecruitment covenant's two-year prohibition against inducing other employees to quit because, the court found, the employer had a protectable "interest in maintaining a stable work force." *Arpac Corp. v. Murray*, 226 Ill. App. 3d 65, 76-77 (1st Dist. 1992).

But federal district courts in Illinois have refused to follow that precedent. In *Unisource Worldwide Inc. v. Carrara*, 244 F. Supp. 2d 977, 983 (C.D. Ill. 2003), the court ruled that all nonrecruitment covenants are invalid under Illinois law as a restraint on trade because they are not supported by any legitimate employer interest.

In contrast, in *YCA LLC v. Berry*, No. 03 C 3116, 2004 WL 1093385, at *17 (N.D. Ill. May 7, 2004), a different federal district court held "that Illinois law declares a covenant not to recruit enforceable, to the extent that it supports the employer's legitimate business interest in guarding his confidential information from potential competitors." The *Berry* court then reformed the nonrecruitment covenant, limiting its applicability to employees "who potentially possess confidential information." Id. at *18.

Thus, while each of these three courts determined that the nonrecruitment covenants were restraints on trade and therefore enforceable under Illinois law only to the extent they furthered a legitimate "protectable interest" of the employer, each court found different protectable interests to different degrees. Significantly, both of the federal district courts ignored the state appellate court's holding that maintaining a stable work force constitutes a legitimate, protectable interest of the employer.

An alternative approach was taken in Missouri, where one state appellate court concluded that a nonrecruitment clause was merely another form of post-employment restraint of trade and, then, declared it to be invalid because it did not "fall within the class of restrictive covenants which may be enforced in Missouri because it is not directed to the protection of trade secrets or customer contacts." *Schmersahl, Treloar & Co. P.C. v. McHugh*, 28 S.W.3d 345, 349 (Mo. Ct. App. 2000).

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That decision, however, was superceded by the Missouri Legislature, which in 2001 enacted legislation, Mo. Rev. Stat. § 431.202, that declared nonrecruitment covenants with any employee to be enforceable and not a restraint of trade even if not directed toward the protection of trade secrets or customer contacts, provided that the restriction does not extend for more than one year after the termination of employment and does not apply to employees providing "only secretarial or clerical services." In fact, under the Missouri statute, a nonrecruitment clause that meets the statutory criteria is "conclusively presumed" to be reasonable.

New York court, changing course, struck down clause

New York law had until recently regarded nonrecruitment covenants as enforceable because such covenants do not violate the state's public policy against post-employment restrictions on competition. *Veraldi v. American Analytical Laboratories Inc.*, 271 A.D.2d 599, 600 (N.Y. App. Div. 2d Dep't 2000).

But in 2005, a New York trial court, in *Lazer Inc. v. Kesselring*, 13 Misc. 3d 427 (Monroe Co., N.Y., Sup. Ct. 2005), reasoned that nonrecruitment covenants were a "restraint on the conduct of an employee" after termination of his employment and, therefore, had to satisfy the threshold requirement that all post-employment restrictions be "no greater than necessary" to protect a "legitimate interest" of the employer. Rejecting the maintenance of a stable work force to be a legitimate employer interest and finding no threat to the employer's trade secrets or confidential information, the court ruled the nonrecruitment clause to be unenforceable as a matter of law.

As the law now stands, the enforceability of nonrecruitment clauses in the employment context varies from state to state, and even between courts in the same state. Some courts view such covenants as perfectly valid either because they do not significantly restrain the former employee's ability to practice a business or trade or because they reasonably protect the employer's legitimate interest in preserving its investment in the training of its workers or the stability of its work force. Other courts, however, require nonrecruitment clauses to be justified by the same criteria as noncompetition covenants, and, by that standard, they almost always fail. NLJ