POST EMPLOYMENT NON-COMPETES AFTER THE *CERIDIAN* CASE: WHEN LESS IS MORE

By George S. Takach

I regularly get asked by clients to help them protect their tech-related assets from a legal perspective. If they are a software company, or even a traditional company like a bank or telco, this means, among other things, preserving the value of their software code. One legal mechanism traditionally used in this endeavor is having key employees sign post employment non-competition agreements. The recent *Ceridian* case, however, illustrates just how careful you have to be drafting these restrictive covenants.

Multiple Legal Levers

Before turning to this new, important judicial decision, it is worth noting that there are multiple ways of employing legal strategies to help a company preserve its core technology-oriented proprietary assets. First is copyright, which protects the software code your team develops – but it only protects against a third party copying the actual software code itself. Therefore, so long as the second comer only reproduces your product's general ideas (which are crafted into the software), then it will be hard to protect them under copyright. By contrast, the most powerful form of IP protection (but also the hardest to obtain), is patent rights, because patents actually protect a particular feature or function of the software, which then nobody can reproduce unless they secure a license from you first.

Finally, often the element you are trying to protect is a trade secret, such as a unique artificial intelligence algorithm and related process that you and your team developed which is much more efficient and effective than anything else on the market. The law will protect your proprietary interest in this new development, so long as you keep it secret. That is, it is imperative to keep a trade secret under wraps, and disclose it only to recipients who have signed strict non-disclosure agreements. This way, you can keep a trade secret your unique "secret sauce" for a long time, and the judicial system will come to your assistance in helping you protect it – but again, only if you manage to keep it secret.

Employees as Trade Secret Destroyers

One of the biggest threats to unauthorized disclosure of trade secrets is, ironically enough, your own employees who helped you develop your trade secret in the first place. And because in effect all companies are "tech companies" nowadays, the practice has developed that employees, when joining your organization, are required to sign a non-disclosure agreement (protecting, among other things, your trade secrets from disclosure by your own staff). Equally, companies use elaborate, and lucrative, compensation plans, including bonuses, and equity or quasi equity (such as options, or phantom option plans) to keep key creative staff happy and from becoming flight risks to minimize the likelihood that they will consciously, or even inadvertently, disclose your trade secrets to a new employer.

Nevertheless, when these mechanisms are insufficient, employers still try to limit somewhat the mobility of their top technical staff by various contractual means, chief among them through having each developer of trade secrets sign a covenant not to compete against the prior employer for some period of time after the employee leaves the employ of the company (let's call this covenant the "NCA", the "Non-Compete Agreement").

A Cautionary Tale

If you want to use an NCA to prevent a software developer employee from leaving your shop and immediately joining your arch rival competitor to do the same for them that the employee was doing for you, you have to craft your NCA very, very carefully. The recent *Ceridian* case teaches how not to do this. In that case Ceridian, which developed HR SaaS-based software, had an employee who took part in some of the development effort supporting parts of Ceridian's software. The employee subsequently left Ceridian to join another company. Ceridian then asserted an NCA, the enforceability of which was the subject of this summary judgment motion brought and lost by Ceridian.

Essentially, if you wish to address such a situation through an NCA (that has any chance of being enforced by a court), then the NCA has to be drafted very narrowly. For example, assume your company develops artificial intelligence software for the banking industry, and the employee does banking-related artificial intelligence software development for you, then in terms of the scope of the activity that the NCA should restrict is only the employee (i) joining another company that does AI software for the banking sector (ii) in order to develop AI banking software for them. But, your NCA should allow the employee to do any other kind of AI software (other than banking-related) for any other kind of company, once they leave you.

One of the reasons the Court in *Ceridian* found the NCA in that case to be unenforceable (for being too broad), was that it purported to limit its former employees from doing anything with a competitor, not merely writing the same sort of software code he had previously worked on. As a judge put it in a previous decision (and this decision was cited by the Court in *Ceridian*), the NCA, if read literally, would have restricted former employees from even being a janitor at a competitor. And the point is, if the former employee is truly a janitor at the competitor, then that role does not threaten to reveal trade secrets in any way – in other words, that extensive restriction no longer operates to protect a vital proprietary interest of the prior employer.

Keep the Restriction As Narrow As Possible

There was another problematic flaw in the NCA used in the *Ceridian* case. It purported to restrict former employees from working not just at a competitor, but also any affiliate of a competitor, even where the affiliates had nothing to do with software development, or let alone developing the type of software (i.e.- HR SaaS-based code) that Ceridian was developing. As the judge put it in the *Ceridian* case, the affiliate could have been in the business of gift cards, which had nothing to do with HR SaaS-based software. So, again, by attempting to cast the protective net too broadly (to include affiliates of competitors in unrelated industries), Ceridian was guilty of overreach.

Therefore, learning from the *Ceridian* case, the reasonable restriction in your NCA should only cover those entities of a competitor that actually make a product or service that competes with the particular product or service that you produce *and* that the employee directly worked on. In effect, you should be content if the employee goes to work for an affiliate of the new employer as a janitor (ie – in another job altogether) when that affiliate is in an altogether different field than you are in.

You might be thinking at this point, "why didn't the judge in *Ceridian* simply cut back the scope of the restriction in the broadly drafted NCA in that case"? The short answer, given by the court in that decision, is that judges will not re-draft NCA's for plaintiffs. While some courts might have done that at one time, those days are long gone. It's up to you to craft your NCA carefully and precisely – don't count on a judge revising it for you! And here's the thing – if the NCA is

too broad, it will be completely knocked out. So, the question to ask is – is it better to get more certainty on a lesser degree of protection, than to go broader in the NCA and end up with nothing?

Not Too Long in Duration, Either

Assuming you have crafted a narrow scope in the NCA, as suggested above, there are a couple more fine tunings you have to do to the clause. First, the duration of the restriction has to be reasonable, which effectively means it should be for a relatively short period of time. For example, if in your market it is typical that a new release of software comes out once each year, then it`s probably safe to say that any restriction longer than 12 months will be considered overly long (and hence will be found unenforceable). In other words, the duration of the protection again cannot be longer than that which is sensibly necessary to protect the reasonable proprietary interests of the prior employer.

The duration of the NCA should also be clear right at the outset when the employee signs the NCA. In *Ceridian*, this was a further problem. In that NCA, there was an unusual mechanism regarding duration: namely, the NCA provided that the duration could be *up to one year*, and that Ceridian would tell the former employees what the actual duration would be at the time employment was terminated. Again, to the Court this amounted to unilateral overreach by Ceridian, and also made the clause void for uncertainty.

Bottom line, to stand any chance of being enforced in a court of law in Canada, the restrictive covenant has to be clear at the outset of the employment relationship so that the employee knows exactly the parameters of the provision. So, to operationalize the lesson from *Ceridian*, your NCA should be of a fairly short duration that reflects the business cycle in your industry, and should not be overly long.

And Geographically Reasonable, Too

There was a further problem with the NCA in the *Ceridian* case. The geographic scope of the restriction was “North America”. However, Ceridian’s customer base was essentially in Canada and the United States. Again, the Court found overreach in the clause, because it held that “North America” included Mexico and the Caribbean, two regions where former employees’ scope of work was not relevant.

Therefore, again, the message is clear. The NCA requires a geographic limitation, and it should be as narrow as the actual geographic parameters of the employee’s day-to-day work. If the employee works in a division that services clients only in Canada, then don`t include the US in your NCA. Or, if the employee covers both Canada and the US, then don`t include Europe. You get the idea.

In conclusion, there are some jurisdictions nowadays where post employment non-competes are truly a non-starter, such as California where they are banned by law. But the Canadian provinces are not there yet. Rather, a very carefully crafted, reasonable NCA still stands a chance of being upheld under the right circumstances, but only if the clause is not guilty of overkill.