Antitrust Implications Arising from the Use of Overly Broad Restrictive Covenants for the Protection of Trade Secrets

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Antitrust Implications Arising from the Use of Overly Broad Restrictive Covenants for the Protection of Trade Secrets

Legal protection for trade secrets is essential to businesses and industries that must communicate valuable information to employees to ensure the efficient functioning of their enterprises. Absent legal protection of this information from unwarranted use or disclosure, this entrustment would not be economically possible because an employer would be reluctant to disclose his valuable trade secret information to an employee if the employee were free to appropriate the information for his own use. Disclosure of trade secrets to employees does not make employers vulnerable, however, because the law provides that employees may not use or disclose trade secrets learned in the course of employment without privilege to do so. Generally, this protection of trade secrets exists in the absence of contract, but employers in many industries require agreements to reinforce the protection as a matter of course. If an improper use or disclosure of a trade secret by a former employee occurs or is likely to occur, the owner of the secret may sue the former employee to enjoin the use or disclosure.


The injunction in some jurisdictions is perpetual, Elcor Chem, Corp. v. Agri-Sul, Inc., 494 S.W.2d 204, 214 (Tex. Civ. App. 1973), and in others is limited to the amount of time it would take the defendant to discover the trade secret, Plant Indus., Inc. v. Coleman, 287 F. Supp. 636, 645 (C.D. Cal. 1968). Perpetual injunctions of former employees have been criticized because they would give an employer the power to eliminate a competitor from the market. See Kubik, Inc. v. Hull, 56 Mich. App. 335, 364, 224 N.W.2d 80, 95 (1974).

For a discussion of when an injunction should be granted, see California Intelligence Bureau v. Cunningham, 83 Cal. App. 2d 197, 188 P.2d 303 (2d Dist. 1948).

Equitable defenses including unclean hands are available to the defendant-employee. Cataphote Corp. v. Hudson, 422 F.2d 1290, 1295-96 (5th Cir. 1970).

An employer seeking an injunction or recovery for the use or disclosure of a trade secret must show a protectable trade secret that he owns, the existence of a duty, or an express or implied agreement not to use or disclose the secret, and actual or probable breach of the agreement. Frodge v. United States, 180 U.S.P.Q. (BNA) 583 (Ct. Cl. 1974).
and in some cases may be awarded compensatory\(^3\) and punitive\(^4\) damages.

The protection given trade secrets impedes, to some extent, the ability of employees to use their knowledge and skills in the marketplace. Such a restraint is justified to the extent that it affords legitimate trade secret protection. The danger exists, however, that employees may be adversely and unjustly affected when employers require broad nondisclosure covenants in employment contracts, which result in extending the scope of the restraint to include information that is not properly protectable.

This Note will address the problem of impermissible employee restraints that result from compliance with overly broad covenants designed to protect trade secrets. It will first review the information that falls within the scope of trade secret protection and the basis for and the methods of protection. The problem of overly broad contractual provisions that restrain employees will then be examined with a focus on the unevenness of current judicial treatment. Finally, the author proposes that employees have a cause of action if they have been harmed by compliance with impermissible restraints.

Definitional Aspects of Trade Secrets

Because many things can be considered trade secrets, an "exact definition of a trade secret is not possible."\(^5\) The Restatement of Torts attempts, however, to give flexible guidelines, including generic categories of items often considered trade secrets: "A trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it."\(^6\) Trade secrets can be defined to include almost any category of information. Virtually no type of information is inherently excluded from

\(^3\) Innersprings Inc. v. Joseph Aronauer, Inc., 128 U.S.P.Q. (BNA) 338, 339 (E.D.N.Y. 1961). The cause of action for damages was recognized at common law, but it is more common and usually more useful to attempt to enjoin disclosure than to seek damages.


\(^5\) Compare Northern Petrochemical Co. v. Tomlinson, 484 F.2d 1057 (7th Cir. 1973) (theft of trade secrets not so exceptional as to permit award of punitive damages) with Sperry Rand Corp. v. A-T-O, Inc., 447 F.2d 1387 (4th Cir. 1971), rehearing denied, 459 F.2d 19 (discussion of punitive damages), cert. denied, 409 U.S. 892 (1972) (award of $175,000 punitive damages against former employee and subsequent employer affirmed where there was a serious breach of loyalty found).

\(^6\) Restatement of Torts § 757, Comment b (1939).

\(^7\) Id.
protection,  but what will be protected as a trade secret depends upon the facts of each case.  

Generally, what is a trade secret is narrowed by excluding information that is not somewhat secret.  Although absolute secrecy is not required in the majority of jurisdictions, mere nondisclosure by the holder will not render otherwise nonprotectable information a trade secret.  Further, no protection is given to information that is in the public domain or that is general knowledge in the trade, even though not public knowledge. Protection is generally granted, however, if the holder has expended time, money, and effort to achieve developments, information, or results not known to others. 

Although the holder must take reasonable measures to preserve secrecy, the protection is not necessarily lost if the holder reveals the secret to another who has an express or implied obligation not to use or disclose it.  Often the holder must divulge the secret to em-

7. Clark v. Bunker, 453 F.2d 1006, 1009 (9th Cir. 1972). In small companies, for example, the information most frequently treated as trade secrets includes manufacturing processes, inventions developed in research, and customer lists. 1971 PATENT, TRADEMARK & COPYRIGHT JOUR. (BNA) No. 57 at A-10, 11.  


The scope of trade secret protection is flexible and evolves to reflect changing technology, market conditions, and societal views. See J. MCCARTHY, TRADEMARK AND UNFAIR COMPETITION 18-19 (1973); Blake, Employee Agreements Not to Compete, 73 HARV. L. REV. 625, 638, 667-68 (1960).

Although the rules respecting trade secret protection are certain, the application of these rules is variable. The parameters of what information is covered as a trade secret and whether some non-trade secret information is protectable are beyond the scope of this Note. For a discussion of these problems, see 12 Business Organizations, MILLGRAM, TRADE SECRETS §§ 2.01-09 (1977), Blake, Employee Agreements Not to Compete, 73 HARV. L. REV. 625, 651-74 (1960).  


ployees, licensees, and patent authorities so that it may be effectively used.

Some information may be appropriate for protection both as a trade secret and as a patent, but a process need not be patentable to be a trade secret. The theories underlying the two types of protection, however, are different. A patent is a limited monopoly that is given in exchange for eventual full disclosure of the information. On the other hand, a trade secret holder often has a natural monopoly with an uncertain duration. This type of monopoly ends upon disclosure of the secret or upon its discovery by proper and independent means. As stated by the Court of Appeals for the Sixth Circuit:

[O]ne who makes or vends an article which is made by a secret process or private formula cannot appeal to the protection of any statute creating a monopoly in his product. The process or the formula is valuable only so long as he keeps it secret. The public is free to discover it if it can by fair and honest means, and, when discovered, anyone has the right to use it.

Both trade secrets and patents are “means to competitive advantage,” and their value “lies in the rights they give to their owners for monopolistic exploitation.” Although a patent owner “can make something which no one else can make because no one else is permitted”

19. The ownership of a trade secret “does not give the owner a monopoly in its use, but merely a proprietary right which equity protects against usurpation by unfair means.” Wexler v. Greenberg, 399 Pa. 569, 583, 160 A.2d 430, 437 (1960).

There is no protection of trade secrets against discovery by “fair and honest means” including “independent invention, accidental disclosure or . . . reverse engineering, that is by starting with the known product and working backward to divine the process . . . .” Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470, 476 (1974), University Computing Co. v. Lykes-Youngstown Corp., 504 F.2d 518, 534 (5th Cir. 1974). The protection is only against “reprehensible means of learning another’s secret.” RESTATEMENT OF TORTS § 757, Comment b (1939); Clark v. Bunker, 453 F.2d 1006, 1009 (9th Cir. 1972).

Protection given trade secrets may last much longer than the 17 year patent term. Protection remains so long as the secret is not duplicated by legitimate means. University Computing Co. v. Lykes-Youngstown Corp., 504 F.2d 518, 534 (5th Cir. 1974).
to do so, the owner of a trade secret frequently "can make something which no one else can make because no one else knows how." 22

Legal Protection of Trade Secrets

Common Law Doctrine of Unfair Competition

The law of unfair competition provides "rules of combat" for use in "trade warfare," 23 which have been characterized as a means of externally controlling the "competitive excesses resulting from basic human aggressions which competition 'channelizes.' " 24 Practices that contravene these rules are considered tortious methods of unfair competition. They include, among others, defaming a competitor, disparaging his goods or business methods, and taking trade secrets by improper means. 25

The misuse of trade secrets by an employee may give rise to a tort action for unfair competition against both the employee and the recipient competitor. Whether the circumstances and nature of the disclosure will in fact be held to be in excess of prescribed conduct depends, however, upon what practices are considered unethical at the time, because the concept of unfair competition is continually evolving. In light of the current trend toward higher standards of fairness and commercial morality, 26 the employer's tort remedy under the law of unfair competition might well be sufficient to restrain both the disclosure of trade secrets by employees and the use of these secrets by competitors. The remedy provided by the law of torts under this doctrine is not the sole protection for holders of trade secrets.

Noncontractual Protection of Trade Secrets

Various theories have been advanced to provide legal protection for trade secrets in the absence of express contractual provisions between employer and employee. 27 Under one theory, disclosure of a secret by an employee after the termination of the employment relationship constitutes a breach of the trust and confidence inherent in the employer–employee relationship 28 and violates the employee's

22. Id.
27. Empire Steam Laundry v. Lozier, 165 Cal. 95, 130 P. 1180 (1913).
28. Futurecraft Corp. v. Clary Corp., 205 Cal. App. 2d 279, 285, 23 Cal. Rptr. 198, 210 (2d Dist. 1962). A basis for protection of trade secrets is that through the confidential relationship the employee acquires knowledge he did not previously have. The employment agreement is given weight in determining the existence of a confidential relationship, but it is not conclusive. Wheelabrator Corp. v. Fogle, 317
duty\textsuperscript{29} to the employer. Another theory has been advanced to the
effect that nonuse and nondisclosure are implied obligations or terms
of the employment relationship.\textsuperscript{30} For this theory to apply the
employee must be aware of the confidential nature of the information.\textsuperscript{31}
Finally, under some circumstances trade secrets have been considered
protected property interests, although reliance on a property theory
appears to be of diminishing importance.\textsuperscript{32}

Despite the trade secret protection afforded employers, an em-
ployee is free to use his skills, experience, and the general information
learned in employment for himself, even in competition with his for-
mer employer.\textsuperscript{33} The ability of the employee to compete, however,
is limited by the requirement that such competition be undertaken fairly\(^3\) without appropriation of trade secrets.

In *Telex v. International Business Machines Corp.*,\(^3\) the trial court found theft of trade secrets in Telex’s hiring of IBM employees. The court outlined the extent of the information a former IBM employee could properly use while working for Telex in competition with IBM. The employee could carry with him and use his general knowledge of IBM’s products, including markets and marketing problems and “even limited general notes of information or opinions respecting the fields of his employment which he had made as a part of his work experience . . . .”\(^3\) To capitalize and exploit confidential IBM documents and studies themselves, however, was improper.\(^3\) Thus, under Telex, employees changing jobs even within the same industry may use the information and skills acquired in their original employment that enable them to continue to work effectively. Despite the guidelines in Telex, an employee, even one not bound by a contract provision, is not free to disclose his former employer’s trade secrets to a new employer.

**Contractual Protection of Trade Secrets**

Because some employers find that trade secrets are becoming increasingly difficult to protect,\(^3\) many attempt to buttress the legally


\(^{36}\) Id. at 315.

\(^{37}\) Id.

\(^{38}\) This difficulty is attributed to, one, the mounting cost and difficulty of litigation, two, the rise in mobility of employees, and three, the decline in a sense of
implied protection by the use of contractual provisions\textsuperscript{39} that explicitly delimit what employees are permitted to do after the employment relationship terminates. The contractual provisions are normally in the form of covenants not to compete or nondisclosure covenants.

In many jurisdictions the use of a covenant not to compete, ancillary to an employment contract,\textsuperscript{40} is considered an effective method of protecting trade secrets.\textsuperscript{41} This type of covenant generally provides that after termination of employment, the employee will not engage in competition with the former employer, either on his own or by working for a competitor. The covenant is usually accompanied by geographic restrictions and a specified time limit. Because this type of provision limits competition, it is an effective means of ensuring that nothing learned in the employment relationship may be used to the employer's competitive detriment. In some jurisdictions, however, a covenant not to compete is unenforceable unless it is specifically designed to prevent unfair competition by protecting trade secrets or confidential information.\textsuperscript{42}

At common law, such post-employment employee restraints were presumptively void because of the possibility of the loss of one's ability to earn a living, the concomitant loss to society, and the possible use of such covenants as a means of monopolizing.\textsuperscript{43} In jurisdictions that allow covenants not to compete, the influence of the common law is seen in the covenants' being viewed with disfavor because they restrain trade by restricting the ability of an employee to engage in his occupation. As a result, the employer seeking enforcement bears the burden of demonstrating the covenants' reasonableness.\textsuperscript{44} Reasonableness is determined by an examination of all of the facts and circumstances, including, but not limited to, the nature of the temporal and geographic restraints.\textsuperscript{45}

\textsuperscript{39} Corporate loyalty. 1971 Patent, Trademark & Copyright Jour. (BNA) No. 57 at A-10, 11.

\textsuperscript{40} Different rules apply to covenants not to compete that are not ancillary to employment contracts. See 6A A. Corbin, Contracts §§ 1379-84 (1962).

\textsuperscript{41} Justin Belt Co. v. Yost, 502 S.W.2d 681, 685-86 (Tex. 1973).


\textsuperscript{44} Arthur Murray Dance Studios v. Witter, 62 Ohio L. Abs. 17, 103 N.E.2d 685, 693 (1952).

\textsuperscript{45} Id.
Generally the reasonableness of a covenant will be determined by balancing the interests of the employer, the employee, and the public. The restriction will be enforced only if it is "no greater than necessary to protect the employer in some legitimate interest . . . not unduly harsh and oppressive on the employee . . . [and] not injurious to the public." This balancing process involves conflicting policies including the employer's interest in protecting his business and secrets, the employee's inherent right to earn a living by using his skill and talent, and the public interest in the promotion of research and "encouragement of competition and the discouragement of monopoly."

Covenants not to compete seem to be illegal in California under Section 16600 of the California Business and Professions Code, which provides that covenants that restrain post-employment competition are void. The section states that, with certain exceptions, "every contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void." Covenants restraining future employment must be distinguished from covenants involving customer lists in which the employee's knowledge regarding customers was gained from the employer. Solicitation using the customer list of a former employer is considered disclosure of a trade secret and can be enjoined in California courts.

Although California appears to reject covenants not to compete as illegal restraints on future employment, it does allow contractual protection of trade secrets by nondisclosure covenants. A nondis-
closure covenant generally provides that an employee will not use or disclose trade secrets after the termination of employment. The covenant is recognized as an independent means for protecting trade secrets in states that do not recognize the covenant not to compete as a means of protecting trade secrets and also is often used as a common companion provision to a covenant not to compete in states in which it is recognized. The nondisclosure covenant, like the covenant not to compete, is subject to judicial requirements of reasonableness.\textsuperscript{51}

Overly Broad Covenants

Both covenants not to compete and nondisclosure covenants can be drafted to restrain employees to a greater extent than is legally permissible. As a condition of employment, an employer may require the employee's assent to a covenant to protect trade secrets that is overly broad. Usually the employee has no bargaining power with respect either to the covenant's inclusion or to the terms of the agreement. He will accede if he wants the job.\textsuperscript{52}

Because determining what constitutes a trade secret is difficult and subject to a vague standard, there is always the danger of overbreadth in the drafting of a nondisclosure covenant. The employer who is unsure of the scope of proper protection may in good faith err on the side of overinclusiveness in an attempt to ensure protection of trade secrets. Because the employee may use general knowledge learned during his employment after he leaves, a provision that the employee must "keep confidential all information"\textsuperscript{53} he has learned as a result of his employment is per se overly broad. The employer by seeking to include information not properly within the scope of the protection afforded by the law of unfair competition may have acted in a way that will have an anticompetitive effect. Thus, an attempt to extend protection to all business information learned is injurious in two respects: it is both an abuse of the unfair competition protection for trade secrets and an impermissible restraint on the employee who complies with it.

The overly broad and impermissible covenant may harm the employee. If he leaves his employer and works in a related industry or field, he cannot totally comply with a provision proscribing the use of all information acquired because he cannot "wipe clean the slate of

\textsuperscript{52} See Blake, Employee Agreements Not to Compete, 73 Harv. L. Rev. 625, 661, 683 (1960).
his memory." Further, the existence of such a provision may make the employee less attractive to a potential employer who wishes neither to become the object of litigation if the former employer seeks to enforce the covenant nor to be frustrated by employee refusals to use and disclose information that is not in fact a trade secret. The employee may consider himself to be bound by the covenant so that in seeking a new employer he has diminished bargaining power.

The United States Court of Appeals for the Ninth Circuit in *Winston Research Corp. v. Minnesota Mining and Manufacturing Co.* discussed the effects on employees of restrictions on the use and disclosure of trade secrets. The restrictions were said to "limit the employee's employment opportunities, tie him to a particular employer, and weaken his bargaining power with that employer. [They] interfere with the employee's movement to the job in which he may most effectively use his skills." According to the court, overly broad restrictions also affect competition and harm the public because

[t]hey inhibit an employee from either setting up his own business or from adding his strength to a competitor of his employer, and thus they diminish potential competition. Such restrictions impede the dissemination of ideas and skills throughout industry. The burdens which they impose upon the employee and society increase in proportion to the significance of the employee's accomplishments, and the degree of his specialization.

An employer's motives in requiring a contract can reach beyond protection for his trade secrets. The court in *Arthur Murray Dance Studios v. Witter* indicated that in determining the reasonableness of a covenant not to compete a proper factor to consider is the possible "real objects" of the employer, which can include the desire

- to remove a competitor and ordinary competition . . . to prevent the employee from quitting, or to suppress or discipline him . . .
- to cause the employee to withdraw from all business . . . [or] to prevent [an] employee from using the skill and intelligence acquired or increased through experience or instruction received in course of work for [the] employer.

As one court summarized, "[T]he protection allowed trade secrets is not a sword to be used by employers to retain employees by the

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55. 350 F.2d 134 (9th Cir. 1965).
56. Id. at 137.
57. Id. at 137-38. See also Wexler v. Greenberg, 399 Pa. 569, 579, 160 A.2d 430, 435 (1960).
59. Id. at 33, 105 N.E.2d at 695-96.
threat of rendering them substantially unemployable in the field of their experience should they desire to resign."

If a covenant is overly broad, the employer has stepped beyond the privilege for protection of trade secrets that the law of unfair competition recognizes. He has imposed an impermissible restriction on the employee bound by the covenant whose compliance thereby may also injure the public.

Judicial Treatment of Overly Broad Covenants

An overly broad covenant will reach a court in two ways. An employee or his new employer advised of the overbreadth and desirous of using nonprotectable information covered by the overly broad covenant may seek a declaratory judgment to limit the covenant. More commonly, however, a former employer will attempt to enjoin disclosure by the employee and the use by him and his new employer of trade information that is ostensibly protected.

Faced with a covenant not to disclose or a covenant not to compete, a court will not enforce provisions of that covenant that are overly broad. Depending upon the facts of the case and the jurisdiction involved the court will either void the covenant, sever the offending portions and enforce the remainder, or enforce the covenant only to the extent reasonable under the circumstances. Although at one time there was a presumption that all covenants not to compete were invalid, today most overly broad covenants are subject either to severance or enforcement to the extent reasonable under the circumstances.

If there has been an improper employee restraint by use of a covenant drafted only in part to protect trade secrets, none of these alternatives is satisfactory. Inequities necessarily result to the employee who complies with the overly broad covenant, and there is no penalty imposed on the employer who has used them. Therefore, although the employer has a compensatory remedy for the employee's disclosure of protectable information, the employee who is restrained improperly under an overly broad covenant has no comparable remedy.


62. This method is sometimes called partial enforcement and does not depend upon the divisibility of the restraint.


64. Id. at 681-82.
Judicial treatment that voids the impermissible restraint, severs these provisions, or only enforces the offensive provisions to the extent reasonable under the circumstances does not afford compensation to the employee for any harm suffered.

Voiding a covenant not to compete that is overly broad will not deter employers from drafting such covenants. A covenant not to compete may be voided with the result that the employee is free to compete with his former employer, but the implied in law protection of the employer’s trade secret remains. The result is that an employer may lose the assurance of no competition from a former employee, but protection against use and disclosure of trade secrets is not lost.

The second method of dealing with overbreadth in covenants not to compete and nondisclosure covenants is severance, which allows the overly broad provisions of the covenant to be disregarded and the remainder enforced. As in voiding, this sanction is insufficient to deter employers from drafting overly broad provisions to restrain their employees. When severence is used,

the divisibility of a promise in excessive restraint of trade is determined by purely mechanical means: if the promise is so worded that the excessive restraint can be eliminated by crossing out a few of the words with a “blue pencil,” while at the same time the remaining words constitute a complete and valid contract, the contract as thus “blue-pencilled” will be enforced.

The use of severence as a method of treating overly broad covenants presents problems in that differences in draftsmanship can lead to uneven results and in that the method does not consider degrees of reasonableness.

The third method of judicial treatment of overly broad covenants is enforcement to the extent reasonable under the circumstances. This method ignores drafting variables and provides for enforcement only of the permissible provisions. An injunction sought by an employer will be granted but will be framed to provide protection only

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65. The Restatement of Contracts advocates voiding a covenant if it is determined that the employer made the covenant with the intention of monopolizing: a promise involving an unreasonable restraint and not divisible is “not enforceable even for so much of the performance as would be a reasonable restraint.” Restatement of Contracts § 518 (1932).

66. 6A A. Corbin, Contracts § 1390 (1962).

67. E.g., Kofoed Pub. Relations Assoc., Inc. v. Mullins, 257 So. 2d 603, 605 (Fla. Dist. Ct. App. 1972). The court held an overly broad covenant not to compete should be enforced to the extent reasonable. To do otherwise would impose too great a duty of foresight and would deprive the parties of their rights to make restrictions on personal competition.
of those interests that the court considers proper. To determine the scope of protection, a court will balance the interests of the employer, the employee, and the public. In *Futurecraft v. Clary*, a California court of appeal outlined the balancing process in which it engages in shaping protection:

Protection should be afforded when, and only when, the information in question has value in the sense that it affords the [ex-employer] a competitive advantage over competitors who do not know of [the trade secret], and where the granting such protection will not unduly hamstring the ex-employee in the practice of his occupation or profession. This simple balancing process will invariably protect all of the pertinent interests—those of the former employer, of the former employee, and of the public.

Although a court will not enforce provisions of an overly broad covenant that constitute an employer's attempt to extend trade secret protection too far, an employee who does not know of the overbreadth may nevertheless attempt to comply with the provisions of the covenant. To the extent that his compliance with the covenant acts to his detriment in the competitive marketplace and to the detriment of the public in restricting his services and in having a monopolizing effect, there is an impermissible restraint of trade. Harm will continue until the covenant is terminated by deliberate noncompliance or by judicial tailoring.

The effect of either method, severance or enforcement to the extent reasonable, is that trade secrets will be protected despite the use of overly broad covenants that can restrain employees and inhibit competition. The dangers to employees that inhere in these approaches have been emphasized:

For every covenant that finds its way to court, there are thousands which exercise an *in terrorem* effect on employees who respect their contractual obligations and on competitors who fear legal complications if they employ a covenantor. . . . . [T]he mobility of untold numbers of employees is restricted by the intimidation of restrictions whose severity no court would sanction. If severance is generally applied, employers can fashion truly ominous covenants with confidence that they will be pared down and enforced when the facts of a particular case are not unreasonable.

69. *Id.* at 288, 23 Cal. Rptr. at 211 (quoting von Kalinowski, *Key Employees and Trade Secrets*, 47 VA. L. REV. 583, 599 (1961) (emphasis in original)).


Application of the Antitrust Laws to Overly Broad Restrictive Covenants

Restrictive covenants in employment agreements can be used by employers as a device to inhibit the free flow of information and employee services, but the employer who uses covenants for this purpose is rarely penalized. This anomalous result is seen by examining the effect of judicial partial enforcement of overly broad covenants whereby the employer is left free to draft overly broad covenants with the assurance that his trade secrets will remain protected. At worst, proscribed provisions will be voided or severed. The repeated use of these types of overly broad covenants, to the extent that employees respect them, may restrain trade and lead to the employer's establishment or maintenance of a substantial position in the market to the detriment of employees, competitors, and the public. The author proposes that there is a currently existing penalty that would tend to remove the economic advantage and incentive for employers to engage in this type of act and that should be used to deter employers from using overly broad covenants.

Theoretically, section 1 of the Sherman Act is available to employees who have been restrained and harmed by the use of either overly broad covenants not to compete or overly broad nondisclosure covenants. In practice, however, affirmative use of the Sherman Act has been unsuccessful in actions by employees to invalidate restraints, and its use as a defense to an action to protect trade secrets has been blocked on procedural grounds. The remainder of this Note will review attempts that have made use of the Sherman Act defensively to defeat such covenants and will consider proposed affirmative use of that Act by employees injured as a result of compliance with overly broad covenants.

Antitrust Claims Raised as a Defense

Attempts by employees to raise antitrust violations as defenses in suits by employers to enjoin use and disclosure of trade secrets have met with little success. A court may be presented with the defense


73. See generally El Salto, S. A. v. PSG Co., 444 F.2d 484 (9th Cir. 1971),
that antitrust violations have been committed that constitute unclean hands, which will preclude injunctive relief. The court may find either that the activity alleged as a defense is insufficiently related to the subject of the suit to permit the use of the unclean hands defense or that even if the relationship is present, denying the trade secret holder protection would be inequitable.

_Glass Laboratories, Inc. v. Crystal_74 illustrates the reluctance of the courts to recognize antitrust defenses. In that case the employer sued in a state court to enjoin the employee's use of trade secrets and to recover compensatory and punitive damages. In addition to denying the plaintiff's allegations, the employee asserted that the employer had engaged in acts constituting unclean hands, including participating in illegal patent pools and conspiring to monopolize, to fix prices, and to allocate customers and markets. The court found that it had no jurisdiction to hear the antitrust issues75 and stated in dictum that, even if there were jurisdiction, the activity alleged as evidence of unclean hands was not sufficiently connected with the matter in litigation. Further, notwithstanding a possible finding of antitrust violations, "equity would not give competitors free reign to damage plaintiff's legitimate property interests"76 by eliminating trade secret protection.

In a case in which the plaintiff establishes an interrelation between the employer's suit and the antitrust defense, such a showing will not necessarily permit the antitrust defense. In _Telegraph Answering Service, Inc. v. Johnston_,77 the defendant showed the necessary interrelation, but the court still rejected the defense. There, the covenants not to compete that the employer was seeking to enforce against former employees were devices used to monopolize the market. Despite the demonstrated connection between the alleged claim and the defense raised, the court held that the antitrust defense was not cognizable in that equity action, stating, "The substance and intent of our ruling is the exclusion of antitrust defenses . . . ."78 Therefore, even in instances in which the nexus between the employer's claims

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75. The court distinguished reliance exclusively on alleged antitrust violations from an allegation that also involved conduct prohibited by common law restraints of trade. _Id._ at 648. See also _TNT Communications, Inc. v. Management Television Sys., Inc._, 1968 TRADE CASES (CCH) ¶ 72,653 (N.Y. Sup. Ct. 1968) (antitrust counterclaim dismissed for lack of jurisdiction).
76. _Id._ at 649.
78. _Id._ at ¶ 86,142.
and the employee’s defenses based on antitrust violations is alleged, courts may treat such defenses very restrictively:79 "[A] Sherman Act violation is not an affirmative defense to a contract suit, even where the violation is inherent in the contract sued upon, so long as judicial enforcement of the contract would not be enforcing the precise conduct made unlawful by the Act."80

As illustrated, the problem of equitable defenses has precluded the use of the antitrust laws as defensive measures in suits brought by employers to protect their trade secrets. If the employee sues affirmatively for harm suffered as a result of attempted improper extension of contractual protection, however, problems peculiar to defenses would not be present.

Affirmative Use of Antitrust Remedies by the Employee

Section 1 of the Sherman Act provides: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal . . . ."81 This section prohibits "those classes of contracts . . . which the common law had deemed to be undue restraints of trade."82 The effect of section 1 was to "adopt the common-law proscription of all 'contracts or acts which . . . [have] a monopolistic tendency . . . and which interfere with the natural flow' of an appreciable amount of interstate commerce."83

Because some relationships have a "'pernicious effect on competition and lack . . . any redeeming virtue,' [they] are conclusively presumed to be unreasonable and thus constitute per se violations of the Act."84 Most contracts, however, violate the Act only if they are found to be actually "unreasonable." Covenants not to compete that are ancillary to employment contracts are subject to the rule of reason.85 Courts have held that the combination or contract to restrain trade can occur even if only one party is benefited86 and that agree-

83. Id., quoting Standard Oil Co. v. United States, 221 U.S. 1 (1911).
ments not to compete, although otherwise lawful, can be used for the purpose of restraining trade or extending a preexisting monopoly.\(^8\) The loss of employment opportunity because of antitrust law violations can provide a basis for recovery of damages.\(^8\) Thus, overly broad covenants that are unreasonable and that restrain trade can violate section 1 of the Sherman Act. The employee who suffers damage from compliance may have an antitrust remedy.

To date, courts have been reluctant to find violations of section 1 of the Sherman Act when presented with covenants alleged to be unreasonable restraints. In *Alders v. AFA Corp. of Florida*,\(^8\) an employment agreement containing a covenant not to compete for five years was executed as an incident to a purchase of one corporation by another. An employee sued to enjoin its enforcement and for a declaratory judgment that the provision was invalid under the Sherman Act. The court initially rejected the employer's attempt to assert an *in pari delicto* defense, holding that in addition to being disfavored in private antitrust actions, the defense was inapplicable in the case because of the employee's noninvolvement in drafting the covenant. The court held, however, that insufficient evidence had been submitted at the trial to meet the employee's burden of proving illegality under section 1 of the Sherman Act. Despite a finding of overbreadth with respect to the geographic restrictions in the covenant, the court, noting the intense competition in the industry and the small market share of the defendant, held that there was no unreasonable restraint and no violation of the Sherman Act.\(^9\)

Failure to show a restraint that was "so substantial as to affect either market prices or commercial freedom" resulted in the dismissal of the employee's action in *Miller v. Kimberly-Clark Corp.*\(^9\) The employee had entered into an agreement restricting his "right to disclose 'information or knowledge' which was not 'generally known' [and which had been] acquired while he was employed at Kimberly-Clark."\(^9\) He demanded a declaration that the covenant was invalid and unenforceable and, using the antitrust laws, sought to restrain its enforcement. The court disposed of the first claim, which did not

\(^9\) It has been recognized that an employer's requiring an overly broad covenant not to compete can constitute an overt act as part of a scheme to monopolize in violation of §§ 1 & 2 of the Sherman Act. Sar Industries, Inc. v. Monogram Industries, Inc., 1976-I TRADE CASES (CCH) ¶ 60,816 (C.D. Cal. 1976).
\(^8\) Nichols v. Spencer Int'l Press, Inc., 371 F.2d 332, 334 (7th Cir. 1967).
\(^9\) Id. at 1296-97.
rely on the antitrust laws, by finding a lack of diversity jurisdiction and by holding that the suit involved a "local contract dispute" and not a federal question. The second claim, based on the antitrust laws, was also found jurisdictionally insufficient because the contract did not constitute a public injury.

Although courts have not been presented with cases in which public injury has been proven, facts demonstrating the existence of numerous unreasonably restrictive employee covenants having the cumulative effect of extending the employer's share of the market may result in a finding that section 1 of the Sherman Act has been violated. Although employees have been unsuccessful in using the Sherman Act offensively against employers who have used overly broad nondisclosure covenants or covenants not to compete to restrain their employees, the courts appear to indicate that, upon a proper showing of an unreasonable restraint of trade, the employee would have a viable remedy.

Employers' attempts to bind employees to them and restrict the flow of information to the public and to competitors have a market effect analogous to "no-switching" agreements, in which employers agree not to hire one another's employees. In each case the employees' services are effectively kept from public distribution by limiting them to one employer. Such agreements work to the disadvantage of new industries that need employees and thereby tend to have an anticompetitive effect.

93. Id. at 1297.
95. See generally By-Buk Co. v. Printed Cellophane Tape Co., 163 Cal. App. 2d 157, 329 P.2d 147 (2d Dist. 1958), in which an injunction granted in response to a claim of misappropriation of trade secrets was held to be so broad as to be a restraint of trade in violation of section 1 of the Sherman Act and of the Cartwright Act, California's antitrust statute. CAL. BUS. & PROF. CODE §§ 16700-58 (West 1964). The injunction prevented the employee from using any machine similar to one made by the plaintiff even if the machine was made without any unfair competition. The court held that the employer was only entitled to a decree to protect against wrongful use of its trade secrets. A motive that is not consonant with intention to monopolize will not save the defendant if unreasonableness can be shown. "Under the Sherman Act the test of validity for any restraint of trade is not the motive of the parties who act in concert. Restraints of trade must be examined not merely for the intent of their creators but for their reasonableness . . . and therefore they must be considered in the light of their impact upon the competitive structure of the industry affected." Union Circulation Co. v. FTC, 241 F.2d 652, 656 (2d Cir. 1957) (citation omitted).
96. The motives in each instance, however, are different. The object of a no-switching agreement is generally to freeze current market shares by the use of a collaborative effort. The overly broad covenant is a unilateral act which can restrain trade and result in an increased market share for the employer.
In *Nichols v. Spencer International Press, Inc.*, an employee affected by an agreement not to employ him sued, alleging antitrust violations. The court stated that

[although] the antitrust laws were not enacted for the purpose of preserving freedom in the labor market, nor of regulating employment practices as such . . . agreements among supposed competitors not to employ each other's employees not only restrict freedom to enter into employment relationships, but may also, depending upon the circumstances, impair full and free competition in the supply of a service or commodity to the public. Consequently, the court held that such a finding constitutes an antitrust violation.

In *Union Circulation Co. v. Federal Trade Commission*, agreements not to hire employees of a competitor were found to be an unreasonable restraint of trade and a Sherman Act violation because the agreements were harmful to competition. The court held that the existence of such agreements has a probable result of freezing the labor supply because an employee will "hesitate to leave his employer in order to join a newly formed competitor, or an expanding established one . . . ." The court concluded that the tendency of the agreements to inhibit labor mobility works to the advantage of the established organizations and to the disadvantage of the newer ones.

The effect of the no-switching agreements on the market is similar to that of overly broad restrictive covenants. In the first instance, an employee will find it difficult to leave his employer because only nonparties to the no-switching agreement will hire him. If there is a broad restrictive covenant, however, not only will employers generally hesitate to hire an employee who is a party to such an agreement, but also an employee will feel unable to work for any competitor in the same industry. The no-switching agreement permits employee mobility insofar as there are employers not party to the agreement who will hire employees. An employee attempting to comply with an overly broad restrictive covenant, however, may believe he can work for no competitor in the same industry. In both instances, employee mobility is impaired, and there is a potential anticompetitive effect in the industry. The overly broad covenant can have an even greater effect on competition than a no-switching agreement. If use of the no-switching agreement will support finding an antitrust violation, the use of an overly broad restrictive covenant with an anticompetitive effect should also be considered an antitrust violation.

97. 371 F.2d 332 (7th Cir. 1967).
98. *Id.* at 335-36.
99. 241 F.2d 652 (2d Cir. 1957).
100. *Id.* at 658.
Conclusion

The effect of overly broad post-employment restraints can be restraint of trade. Employee compliance with such restraints may prevent the free flow of information and employee services to the detriment of employees, competition, and the public. Despite the continued existence of these overly broad restraints, employers to date have not been subjected to any sanction except court ordered nonenforcement of the provisions that are overly broad.

Although the defensive use of the antitrust laws by employees in suits by employers to enforce trade secret rights appears to be fraught with procedural difficulties, the employee has a remedy in the affirmative use of section 1 of the Sherman Act. The employee whose employment opportunities are adversely affected because of an overly broad restrictive covenant is not precluded from suing the employer despite the employee's acceptance of the covenant as a term of employment.

The major hurdle in suits by employees under the federal antitrust laws involving overly broad covenants has been making a satisfactory factual showing of an unreasonable restraint of trade as a result of the covenants. The burden could be met, however, by demonstrating the cumulative effect of overly broad covenants in wide use in a particular industry. Despite the problems of proof involved, the use of section 1 of the Sherman Act is a viable remedy for employees who have been injured by the existence of overly broad restrictive covenants.

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