Report on a Case by the Board of Ethical Review

Case No. 88-3

Restrictive Employment Agreement

Facts:
Engineer A is the president of a company that designs and manufacturers a wide range of consumer products. Engineer A's company employs many engineers on staff who have a wide range of responsibilities for the company. Upon hire, each of the design engineers is required to sign an agreement covering employee inventions and writings, confidential information, and non-competitive employment. Engineer A decides to include in the agreement the following clause: "In the event that my employment with the company is terminated without regard to whether such termination is voluntary or involuntary, I agree for a period of eighteen months after termination, I will not, directly or indirectly, become employed by or render any services of an advisory nature or otherwise, or participate or engage in any business competitive with the company's business without first receiving the prior written consent of the company. I further agree to notify the company in writing during this non-compete time period of any offers of employment received from a competitor or possible competitor of the company by me at least two weeks prior to the commencement of any such employment. The company will inform me as to whether it consents to such employment by mailing a registered letter within three working days of receipt of notification to my last known address. In the event the company does not consent to the providing of services or employment for a competitor during the non-compete time period, the company agrees to pay me on a monthly basis at the rate of one third of my last monthly salary with the company starting with the time of denying consent and up to a maximum time period of eighteen months to coincide with the non-compete time period as consideration for my not participating or engaging in any business competitive with the company's business."

Question:
Was it ethical for Engineer A to include the employment agreement in the aforementioned clause?

References:
Code of Ethics - Section III.4. - "Engineers shall not disclose confidential information concerning the business affairs or technical processes of any present or former client or employer without his consent."

Section III.4.a. - "Engineers in the employ of others shall not without the consent of all interested parties enter promotional efforts or negotiations for work or make arrangements for other employment as a principal or to practice in connection with a specific project for which the Engineer has gained particular and specialized knowledge."

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Section III.8. - "Engineers shall not attempt to injure, maliciously or falsely, directly or indirectly, the professional reputation, prospects, practice or employment of other engineers, nor untruthfully criticize other engineers' work. Engineers who believe others are guilty of unethical or illegal practice shall present such information to the proper authority for action."

Discussion:
In some respects, an interpretation of a restrictive employment agreement is more a matter of law than of ethics. However, as has been stated on many occasions by this Board, legal and ethical issues are frequently bound together and the ethical dimensions of the question must be independently analyzed in order to gain a fuller understanding of the problem presented.

In fact, the Board has had occasion to review a previous case involving a restrictive employment agreement and the language contained in Section III.4. and III.4.a. in a different context. In Case 72-5, the consulting engineering firm required all of its engineering employees to sign the following agreement as a condition of employment: "The undersigned hereby agrees on the date and place mentioned above for the sum of One ($1.00) Dollar and other considerations that upon leaving the employ of (name of firm) that he will not become engaged in or become interested in, directly or indirectly, as an Owner, Partner, Proprietor, or Principal, in any business, trade or occupation providing Architectural, Engineering or Planning services within a geographical area of a One Hundred Mile (100) radius of any office established by the (name of firm) at the time of his termination within a period of Two Years (2)."

In ruling that it was unethical for the engineer principals of the consulting firm to require engineering employees to sign the above-quoted agreement as a condition of employment, the Board noted that it was deeply concerned about the ethics of private practice engineers applying a principle of restrictive employment conditions, however much it may be warranted to meet special problems, if the restrictions go too far. We noted our unhappiness with the restrictive employment agreement because it totally prevented a former employee from establishing a competing firm, even in the absence of improper conduct. Said the Board: "Literally read, the clause prevents a former employee from offering his services on the most ethical basis to anyone in the covered area, leaving the impression that the firm of the former employee seeks to hold its clients by legal machinations rather than on the basis of demonstrated performance."

As we noted earlier, Case 72-5 dealt with the restrictive employment agreement of a private practice firm rather than a manufacturing company. There are significant differences between the activities and requirements of a private practice firm and those of a manufacturing corporation. Engineers in industry may be privy to highly confidential information, trade secrets, patented products and processes and other materials. Therefore, it is arguable that an industrial employer should be permitted wider latitude in the use and scope of restrictive employment agreements. Nevertheless, it should be acknowledged that in today's economy, confidential information of a private practice firm,

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including client information, marketing techniques, and business associations may be just as valuable to a private practice firm as proprietary information such as manufacturing trade secrets is to a manufacturing company.

As in Case 72-5, the Board must determine whether the agreement in question is appropriate to the circumstances at hand or whether the agreement was too overbroad. It is our view that by its terms the agreement went too far and Case 88-3 therefore is in violation of the Code of Ethics. There are several reasons for our view.

First, the agreement is not reasonably limited as to time. It would apply equally to an employee who worked for the company for one month as it would to an employee who worked for the company for ten years. Second, the agreement is not limited as to geography. It would not merely restrict an employee's activities in the state in which the company's office is located or even in the U.S. It would apply to all world-wide operations of the company. Third, the agreement is inherently unfair because it would require former engineer employees of the company, who have developed a particular technical expertise, to remain unemployed for a period of 18 months and collect one-third compensation. Any agreement which, by its terms, forces an engineer to remain out of work is in direct violation of Section III.8. of the Code because it clearly "injures . . . the prospects . . . or employment of another engineer." Fourth, the agreement is not narrowly limited to any substantive area of company operations but rather broadly applies to all aspects of company activities. For example, under this agreement, an employee would not be permitted to accept a position with a competitor even if the competitor planned to assign the employee to a division whose activities and functions had no connection with the employee's previous activities.

As we noted earlier, while agreements of this type are not uncommon and are enforceable if reasonably restricted, we believe this agreement goes well beyond reason. Engineers who require their engineer employees to sign them should consider whether the agreements are intended to protect the legitimate proprietary rights of the employer or whether they are intended to unduly restrict the mobility of engineer employees. In the present case, we believe the intent of Engineer A was the latter.

Had the facts provided that the agreement would be restricted only as to those technical areas and proprietary information in which the two employers were in direct competition, this Board might reach a different result.

The Board is aware of covenants not to compete which are negotiated as part of the sale of consulting engineering practice. Unlike restrictive employment contracts, such covenants are freely negotiated, voluntary, and not imposed as a condition of employment.

Conclusion:
It was unethical for Engineer A to include in the employment agreement the aforementioned clause.

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