

Employee Noncompetition Agreements

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Employers often ask: “Are noncompete agreements enforceable?” The answer is yes — and no. Courts generally enforce reasonable agreements when necessary to protect particular employer interests. On the other hand, courts generally do not enforce noncompete agreements when no real protectable interests are at stake, the restrictions are unreasonable, or the employer has undermined its ability to enforce them by, for example, engaging in “selective enforcement” of such agreements. This article reviews some noncompete basics, addresses steps employers should take to put enforceable agreements in place and describes what an employer can do upon learning that an employee is leaving to join a competitor.

I. Putting Agreements in Place

When Is a Noncompete Appropriate?

A noncompetition agreement is a type of “restrictive covenant,” i.e., a promise by an employee not to engage in certain behavior that is contrary to the employer’s interests. A covenant “not to compete” generally is a promise that the employee will not engage in business competitive with the employer during and for a certain time period following termination of employment. Such covenants are often accompanied by covenants “not to solicit” the employer’s customers and covenants “not to disclose” the employer’s confidential business information.

To be enforceable, a noncompete must be (i) necessary to protect certain employer interests, (ii) reasonable in time and scope, (iii) consistent with public interest and (iv) supported by consideration. Courts recognize two key protectable employer interests: an employer’s relationship with customers, clients and vendors (also called “**good will**”) and **trade secrets** and other **confidential business information**.

Goodwill encompasses a variety of intangibles, including market position and reputation. Confidential business information encompasses commercially valuable information not generally known outside of the company, which the company has taken reasonable measures to protect. Unless good will or trade secrets/confidential business information is at stake, an employer cannot prevent an employee from leaving to go to a competitor. In other words, noncompetes can be used to prevent unfair competition (involving misappropriation of good will or confidential business information) but not ordinary competition.

Before requiring an employee to sign a noncompete the employer should ask itself: Will this employee control customer relationships and/or have access to confidential business information? Will the employee be in a position to harm the employer’s business if the employee were to use the good will or confidential information on behalf of a competitor? If the answer to both questions is yes, then the employer should consider whether covenants not to solicit customers and not to disclose confidential information are adequate to protect the employer’s business interests, or whether it is necessary for the employer to restrict the employee from even working for a competitor.

The unnecessary and overly broad use of noncompetes may negatively impact an employer’s ability to enforce such an agreement when it really matters. If every employee from the night janitor to the CEO is expected to sign a noncompete, a court may question whether any protectable interests are truly at stake.

What Is the Proper Scope of Noncompete Restrictions?

Noncompetes must be reasonable in duration and geographical scope. Employers are at risk if they draft agreements in broad terms and presume that a court will enforce them on a scaled back basis. In Massachusetts and many other states courts may scale back overly broad noncompetes as appropriate, but courts also may refuse to enforce unreasonable noncompetes altogether. The much better approach is for employers to use noncompetes that provide only the protection needed.

Except in situations involving a sale of a business, noncompete restrictions of more than one year in duration may not be enforced. In some lines of business six months may be more appropriate. Further, it is not unusual to set different durations for different types of restrictive covenants. For example, an agreement may provide that non-compete restrictions continue for six months while the covenant not to solicit customers continues for one year and the covenant not to disclose confidential information continues indefinitely.

The appropriate geographical scope for a noncompete usually depends on the nature and scope of the employer's business and the protectable interest(s) at stake. Where good will is the only business interest involved and the employee's customer contact is limited to a particular region, the noncompete should be limited to that region. Where confidential business information is the business interest (and a covenant not to disclose may not provide adequate protection), it may be appropriate for the noncompete to have no geographical limitations.

Because the scope and types of restrictive covenants that are appropriate typically vary from position to position, it is often not possible (or at least not wise) for an employer to have a one-size-fits-all agreement for all employees to sign. Moreover, courts may be more inclined to enforce a noncompete that is specific to a particular employee, as opposed to a fill-in-the blank agreement.

What Must an Employee Receive in Exchange for the Noncompete?

Noncompetes and other restrictive covenants must be supported by "consideration." This means that an employee must receive a benefit — either a promise or something else of value — in exchange for the employee's promise not to work for a competitor. When an employee is presented with a noncompete prior to starting new employment, there is no question that consideration exists to support the agreement. In this situation, the employer should make the requirement of signing a noncompete clear in its offer letter so that the employee cannot later assert that the noncompete was imposed after the offer of employment was accepted. In fact, we suggest that employers attach a form of the noncompete to the offer letter so that the employee cannot later claim that he or she did not receive full disclosure of the restrictive covenants.

When an employee is asked to sign a noncompete "mid-employment" the employer can take the position that continued employment of the employee constitutes sufficient consideration to make the noncompete covenant enforceable. However, the law is unsettled in this area, and some courts have held that the promise of continued at will employment does not suffice. Consequently, we recommend that employers offer employees something of value as additional consideration for mid-employment noncompetes. This consideration can be in the form of additional compensation, such as a raise, bonus, stock options, or acceleration of a benefit.

What happens to a noncompete if an employee's position changes due to a promotion or transfer? A few Massachusetts cases have held that each time an employee's relationship with an employer changes materially, a new noncompete must be signed. Whether a particular promotion or job transfer is a material change is a matter of degree. Consequently, we recommend that employers review the noncompete (and other restrictive covenants) for each employee who has a change in position. An employer may require the employee to sign a new noncompete, or sign a document acknowledging the position change and that the employee's noncompete remains in effect. A less burdensome (but possibly less effective) response to this issue is to include in all restrictive covenants language which puts the employee on notice that

the covenant will remain in force and effect regardless of any changes in the terms and conditions of employment, including changes in duties, position or compensation.

What Are Other Important Provisions and Considerations?

Injunctive Relief and Attorneys' Fees

Noncompetes should identify the protectable interests and include an acknowledgement that the interests are vitally important, that breach of the noncompete will cause irreparable harm to the employer's business, and that the employer is entitled to immediate injunctive relief in the event of such breach. Noncompetes also should require the employee to reimburse the employer for its attorneys' fees if the employer has to file suit to enforce the agreement. While a court ultimately may choose not to enforce an attorneys' fees provision, the existence of such a provision can provide substantial leverage to the employer.

Choice of Law and Forum Selection

Noncompetes should provide that the law of a particular state, such as Massachusetts, controls the interpretation and enforcement of the noncompete agreement, that all actions involving disputes arising under the agreement must be brought in the particular state, and that the employee consents and submits to the jurisdiction of the courts in the state. Many employers have multistate operations and in some states, most notably California, noncompetes may be enforceable only in very limited circumstances. "Choice of law" and "forum selection" clauses give employers some degree of predictability in assessing the likely outcome of a noncompete dispute, as well as where it will be litigated.

Assignment

Noncompetes should expressly permit the employer to assign the agreement to an acquirer. The existence of enforceable noncompete agreements for key people is often an important issue when a business is being acquired. Unless a noncompete contains a proper assignment clause, courts are unlikely to permit the assignment of the noncompete to the acquirer without the employee's express consent.

Take a Careful and Consistent Approach

Employers should take steps to ensure that all restricted covenants are, in fact, (i) signed by the employee and employer and (ii) maintained in a secure place. It is not unusual for an employer to discover that a signed noncompete is "missing" after an employee has left to join a competitor. Employers should also be careful to treat confidential business information as confidential. Developing a program to protect proprietary information and trade secrets (e.g., labeling "confidential" and restricting access) strengthens an employer's position that its business information is truly confidential and that the restrictive covenant should be enforced.

II. Steps to Take When an Employee Leaves for a Competitor

Having effective agreements on paper does little to protect an employer's interests unless the employer is prepared to take action to enforce its rights. Employers should treat departing employees with noncompetes in a consistent way by (i) reminding them of their continuing obligations upon termination, (ii) promptly sending "cease and desist" letters upon learning that they are engaging in competitive activities, and (iii) being prepared to take prompt legal action when they do not comply with the employer's demands. Being ready and willing to take appropriate action can preempt a threat to the employer's business interests before harm occurs, and, perhaps as importantly, can send the message to the employer's current and former employees and its competitors that the employer takes seriously threats of unfair competition.

The Exit Interview: Remind Departing Employees of Their Continuing Obligations (and Collect Information)

Conducting exit interviews with departing employees serves two important goals. First, an exit interview presents an opportunity to remind departing employees of their continuing obligations to the employer. We recommend that employers review the terms of the employee's noncompetition agreements with the employee during exit interviews so that departing employees understand their obligations (and understand that the employer takes these

obligations seriously). Be sure that managers are trained to properly conduct such interviews so that they do not unwittingly agree to limit the scope of the noncompete in their discussions with departing employees.

Second, an exit interview can be helpful in gathering information to assess the threat posed by a departing employee. Too often employees leave employment stating that they are “pursuing other opportunities” but immediately begin working for competitors in capacities that breach their noncompetes. A former employer may not learn of a breach until weeks later, after much harm has occurred and the ability to enforce the noncompete has been undermined.

A departing employee should be questioned about future plans so that the employer can learn if the employee intends to work for a competitor and what activities the departing employee will perform for the new employer, or whether the departing employee intends to start a venture that may be competitive with the former employer. If a departing employee denies going to work for a competitor and then does so, the employee’s misrepresentation may well be held against him or her if litigation ensues.

Employers should also ask departing employees to verify that they are not keeping any company property or documents that contain confidential or proprietary business information. Particular attention should be paid to a departing employee’s laptop computer and work station. Employers should assess the need to preserve and/or immediately review emails and other information stored electronically for evidence showing that the departing employee has breached or intends to breach a noncompete. As a follow-up to exit interviews, employers should consider issuing a letter to the departing employee that outlines the employee’s continuing contractual obligations to the employer and the independent duties owed the employer under statutory and common laws that protect trade secrets.

Additionally, noncompetes sometimes include a provision by which the employee agrees that the employer may forward a copy of the noncompete to future employers. This step can be useful in alerting potential competitors about the existence of the agreement (so that they cannot later claim they were unaware of the employee’s continuing obligations), however, this should be done carefully so as not to risk a claim of unlawful interference with the former employee’s relationship with his or her new employer or a defamation claim by the former employee.

Along the same lines, when an employee who had contact with customers departs for a competitor, an employer should take steps to protect the customer relationship, such as informing the customer that the former employee has departed and introducing the customer to its new contact at the employer. Keeping the lines of communication open with customers is important for another reason: customers are often the first to report that a former employee is soliciting the former employer’s customers in breach of the noncompete. Again, such communications must be handled with care to limit exposure to claims of defamation by the former employee.

Assess the Situation Quickly

Employers must evaluate expeditiously whether the employee’s job with a competitor threatens the employer’s goodwill, trade secrets and/or confidential information. Employers cannot sit on their rights in these situations because delay may hinder the employer’s ability to obtain legal protection. The following are questions the employer should answer as soon as possible before determining its response:

- Is the former employee’s new employer or new business venture competitive?
- What activities will the former employee be performing for the new employer? (Will he or she be calling on the former employer’s customers for the new employer and/or disclosing trade secrets or confidential pricing information?)
- Will the former employee’s activities breach one or more of the restrictive covenants

contained in the agreement?

- How will the former employer be harmed? Will customers be lost? Will valuable trade secrets be exposed?

"Cease And Desist" Letters: A Shot Across the Bow May Achieve the Desired Result

Once the employer has determined (or has a good faith belief) that a former employee is breaching a noncompete, typically the next step will be to engage legal counsel to send a demand or "cease and desist" letter to the employee. A well-drafted demand letter contains an accurate summary of the contractual, statutory and common law restrictions that bind the former employee, a summary of the facts showing that the former employee is in breach of his or her noncompete (or statutory or common law), a description of the harm suffered or potential harm the employer may suffer as a result of the former employee's breach of duties, and a demand for specific actions and written assurances.

In many noncompete situations, it is also appropriate at this stage to send a separate demand letter to the former employee's new employer setting forth the facts and arguments as to why the new employer's engagement of the former employee will unlawfully interfere with the noncompete between the former employee and old employer. Cease and desist letters must convey the message that the former employer takes the former employee's continuing obligations seriously and will not allow its goodwill, trade secrets or confidential information to be unlawfully misappropriated. These letters are a critical tool because many noncompete situations are resolved by settlement following the exchange of the cease and desist letter and response.

Filing Suit for a Temporary Restraining Order, Preliminary and Permanent Injunction and Damages

If the noncompete situation is not resolved by the sending of cease and desist letters, then the employer must assess whether it will file a lawsuit to enforce the noncompete. Unlike most lawsuits, where the goal typically is to win a judgment awarding money damages after what is usually a lengthy process leading to trial, the goal in most noncompete situations is to obtain an immediate order from the court. This order is called a preliminary injunction (or in certain emergency situations a temporary restraining order). A preliminary injunction will order the former employee (and new employer) to stop taking certain actions, such as working for a competitor altogether, calling on certain customers for the new employer, or using or disclosing confidential and proprietary information. If the former employee or new employer violates the preliminary injunction, they are in contempt of court. The idea is that the preliminary injunction will stop the conduct, preserve the status quo between the parties, and prevent further harm to the former employer. A permanent injunction is issued after trial.

Obviously, the decision to file suit and seek a preliminary injunction must be evaluated carefully given the expense and uncertainty of litigation. This is particularly so in noncompete situations where the outcome of litigation is often influenced to a large degree by particular judges' views on noncompetes generally. In order to obtain a preliminary injunction, the employer must establish that it is entitled to such relief by showing that: the employer is likely to prevail on the merits of the case at trial; the employer faces irreparable harm; the balance of harm (that facing the employer as compared with the harm the former employee could suffer by, for example, not being able to work for a particular new employer) favors the issuance of an injunction; and the public interest is not adversely affected by the issuance of a preliminary injunction.

In addition to assessing whether this standard can be met, the employer should pause to consider whether it will come to court with "clean hands" (that is, whether it has acted fairly). The issuance of a preliminary injunction is a matter squarely in the judge's discretion and is a matter of equity (fairness), so it is important that the employer not overreach but rather only seek the protection necessary to prevent the misappropriation of goodwill, trade secrets, and confidential information. Similarly, before embarking on litigation, the employer should evaluate whether it has breached any obligation to the former employee (such as the obligation to pay

salary or commissions). Such facts will influence whether the court will grant an injunction, and also will likely result in the assertion of counterclaims against the employer in the lawsuit.

The assessment of whether to file a lawsuit must be made quickly. Delay undermines the argument that the former employee's current actions are actively harming the employer's business, and may in rare cases result in the former employee filing suit to obtain a declaration from the court that the noncompete is unenforceable. Filing promptly protects the employer's interests and secures the advantage of being the first to file.

For more information, please contact **Matthew Mitchell**.