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An Overview of Emerging Trends in the Law on Restrictive Covenants & Practical Tips for Drafting Enforceable Non-Competition Agreements

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In recent years, lawmakers and the courts have increasingly sought to narrow the enforceability of restrictive covenants and in particular non-competition and non-solicitation clauses in employment agreements on public policy grounds that favor unrestrained trade and employee freedom. Notably, in April of this year, the Mobility and Opportunity for Vulnerable Employees (MOVE) Act was introduced in Congress and, if passed, would ban the use of non-compete agreements nationwide.[1] Although this legislation is unlikely to become law under the present administration, it is consistent with recent trends following the Obama administration's "call to action" for restrictive covenant reform, which encouraged states to limit and in some cases ban non-compete clauses in employment agreements.[2]

In light of these reform efforts and the rapidly changing legal framework, it is imperative that employers review their restrictive covenant agreements with an eye toward compliance with applicable state law to increase the likelihood of enforcement by the courts. This article will highlight the differing state law approaches to the enforceability of restrictive covenants in employment agreements and other contexts, as well as provide practical tips for drafting enforceable restrictive covenant agreements.

Presently, non-compete agreements are enforceable in nearly every state to some degree. But the extent of enforcement depends on statutes and/or case law that can vary significantly from state to state. Generally, however, non-compete agreements in employment are enforceable provided they are supported by adequate consideration and contain reasonable restrictions as to duration, scope, and geographic area that are narrowly tailored to protect a legitimate business

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[1] *Warren, Murphy, Wyden Introduce Bill to Ban Unnecessary & Harmful Non-Compete Agreements*, Elizabeth Warren Newsroom / Press Release (Apr. 26, 2018), https://www.warren.senate.gov/newsroom/press-releases/warren-murphy-wyden-introduce-bill-to-ban-unnecessary-and-harmful-non-compete-agreements.

[2] *State Call to Action on Non-Compete Agreements*, Obama White House Archives, https://obamawhitehouse.archives.gov/sites/default/files/competition/noncompetes-calltoaction-final.pdf (*last visited* November 12, 2018).

interest.[3] Those interests can include protecting trade secrets, confidential information, customer relationships, or goodwill, and the employer's investment in specialized training or development. And, the majority of states permit the courts to reform, delete or modify overly broad non-compete agreements to render the covenant enforceable consistent with the contract's original intent ("blue-pencil" and/or "equitable reform" doctrines).[4]

However, a handful of states, including California, North Dakota, and Oklahoma, have banned non-compete agreements altogether subject to some narrow exceptions,[5] while other states restrict use of non-competition agreements by industry, profession, or by subject matter.[6] Still, other states require that the courts must declare an entire non-compete agreement void if any provision is found to be unenforceable under applicable law ("red-pencil" doctrine), as in the case of Virginia and Wisconsin.[7] In these jurisdictions, the employee's interest in earning a living and advancing in their chosen career field is paramount to the employer's business or contractual interests with limited exceptions.

In contrast, non-competition clauses in franchise or distributorship agreements or in connection with the sale of a business may be more readily enforceable than within the employment context given the parties' relatively equal bargaining power. The validity of such restrictions are typically evaluated by the same standards applied to non-compete clauses in

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[3] *See, e.g., Raimonde v. Van Vlerah*, 325 N.E.2d 544, 547 (Ohio 1975).
[4] *Id.*; Mich. Comp. Laws §§ 445.774a(1); *Hess v. Gebhard & Co.,* 570 Pa. 148, 162-63 (2002).
[5] *See* Cal. Bus. Prof. Code §§ 16600, *et seq.*; N.D. Cent. Code § 9-08-06 (exceptions for sale of a business or dissolution of partnership); 15 Okl. St. Ann. § 217 (exceptions to general prohibition include sale of a business as a going concern and dissolution of a partnership).
[6] For example, on June 26, 2015, Hawaii's governor David Ige signed Act 158, which voids any "noncompete clause or a nonsolicit clause in any employment contract relating to an employee of a technology business." And, in Colorado,, non-competes are void except for the protection of trade secrets or the recovery of expenses relating to training and educating an employee who has been employed for less than two years. Colo. Rev. Stat. Ann. §§ 8-2-113, *et seq. See also* Ga. Code Ann. §13-8-53 (providing that a noncompete can be enforced only against salespeople, managerial employees, or other key employees or professionals).
[7] *See Lanmark Tech., Inc. v. Canales*, 454 F.Supp.2d 524, 529 (E.D.Va. 2006)*; Gary Van Zeeland Talent, Inc. v. Sandas*, 267 N.W. 2d 242, 250 (Wis. 1978).

employment agreements, in that the scope, duration, and geographic area must be reasonable and necessary to protect a legitimate business interest other than ordinary competition. However, additional legitimate business interests such as preventing customer confusion and deterring other franchisees from breaking away may support broader restrictions. For example, courts have enforced post-termination restrictive covenants or sale of business non-compete agreements ranging from six months to five years and with geographic limits of up to 100 miles or in some cases nationwide.[8]

Given the myriad approaches to non-compete enforcement, determining what restrictions are reasonable and necessary to protect a business's interests requires a case-by-case analysis and depends on the specific business interests or needs at stake and the applicable state statutes and case law. Against this backdrop, businesses can follow some general parameters to increase the likelihood that their restrictive covenants will be enforceable.

First, employers need to consider carefully what law is likely to apply to a restrictive covenant agreement with its particular employees and include an appropriate a choice of law clause in the agreement that is most likely to hold up in court. In the absence of a choice of law provision, courts will often apply the law of the state in which the employee primarily resides and works, which can be fatal to the enforceability of a non-compete agreement, and in some instances, non-solicitation agreements. Similarly, where the state identified in the agreement has no relationship to the parties or the subject of the contract, some courts may refuse to enforce the parties' choice of law in favor of the law of the state in which the employee lives or works.[9] And, at least two

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[8] *See E.T. Prods., LLC v. D.E. Miller Holdings, Inc.*, 872 F.3d 464 (2017); *Certified Restoration Dry Cleaning Network, LLC v. Tenke Corp.*, 511 F.3d 535, 547 (6th Cir. 2007); *Techworks, LLC v. Wille*, 770 N.W.2d 727 (Wis. Ct. App. 2009).

[9] *See* Restatement (Second) of Conflicts Section 187, which provides that a court will generally enforce a contractual choice of law provision so long as (a) there is a substantial relationship to the parties or the transaction and the law selected; and (b) the law chosen is not contrary to the fundamental public policy of a state with a materially greater interest than the chosen state in the dispute.

states have gone so far as to hold that an out of state choice of law clause in a non-compete is void and unenforceable against their residents.[10] Thus, employers and their counsel are well advised to select the law of a state that has the most meaningful connection or relationship to the contract to ensure more predictability in enforcement; for example, a state where the employer conducts business or has a protectable interest, or perhaps the safest bet, where the employee works or lives.

Once counsel has identified each of the state laws that might apply to a restrictive covenant agreement, the employer should identify the business interests at stake in the employment relationship and select the right tool to protect those interests most likely to withstand legal challenges to enforcement. For example, a comprehensive non-competition, non-solicitation, and confidentiality agreement may be overreaching if the interest at stake is limited to protection of the company's trade secrets or confidential information.[11] In that case, a carefully crafted non-disclosure/confidentiality agreement of unlimited duration may be sufficient and has a better chance of being enforceable and when combined with available trade secret protections, including the recently enacted federal Defense of Trade Secrets Act.[12]. Likewise, if protecting customer relationships or goodwill is the chief concern, a non-solicitation agreement may be the best option. Non-solicitation agreements are often subject to less scrutiny by the courts than a non-compete agreement and are commonly enforced where the restrictions are narrowly drawn to prevent the

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[10] *See Osborne v. Brown & Saenger, Inc.*, 2017 ND 288, 904 N.W.2d 34 (rejecting the enforcement of contract clauses that choose another state's law and venue in non-compete agreements); Cal. Lab. Code § 925 (precluding employers from requiring employees who primarily reside and work in California to agree to out of state choice of law and forum selection clauses, except in cases where the employee is represented by legal counsel in negotiating the contract).

[11] Indeed, in Hawaii, for example, restrictive covenants are only enforceable to the extent necessary to protect trade secrets or confidential information. Haw. Rev. Stat. § 480-4.

[12] Note, however, that under the DTSA, double damages and attorney's fees are available only if employers comply with the Act's notice requirements and advise employees of the whistleblower protections available under the law. 18 U.S.C. § 1833.

employee from poaching current or former customers or territories that the employee actually serviced during their employment.[13]

But, if protecting a combination of these interests or a company's investment in workforce development and specialized training is the primary issue, a carefully crafted comprehensive non-compete may just be in order. Under such circumstances, the path to ensuring enforcement lies in drafting reasonably drawn restrictions tailored to the specific business interests at stake. Again, the duration, geography, and scope should be no broader than necessary to protect the employer's legitimate business interest. While up to two years in duration is widely seen as reasonable, a better rule of thumb is from six months up to a year, which is less likely to be construed as anti-competitive. And, although selecting a nationwide (or even worldwide) area is tempting, the safest best is to stick with the region or territory in which the employee worked or served the company's clients.

Further, limiting the scope of prohibited competition to similar industries, work, or activities performed by the employee, is more likely to be enforced than a blanket restriction from performing any work in the employer's industry. The key consideration should be whether the employee is really in a position to threaten your business unfairly if they begin working for a competitor in an unrelated position or field.

Moreover, employers must evaluate whether there are procedural considerations or limitations to enforcement of a non-compete under the applicable law. Some states require that the employer notify the employee that a non-compete will be required prior to extending the employment offer.[14] And while an initial offer of employment is ordinarily sufficient consideration

[13] *See, e.g., Moore Bus. Forms, Inc. v. Wilson*, 953 F. Supp. 1056 (N.D. Iowa 1996).
[14] *See, e.g.,* M.G.L. c. 149, § 24L(b)(i) (Massachusetts Noncompetition Agreement Act provides that for new hires, the noncompete must be presented at or before the formal employment offer or at least10 business days before the first day of employment).

for new hires, the promise of continued employment for current employees may not be and additional, independent consideration, such as participation in a bonus or incentive plan, may be required.[15] Further, the manner of the employee's separation may adversely affect the enforcement of a non-compete, with some states refusing to enforce a non-compete where the employee was laid off or terminated without cause.[16] Likewise, enforcement of a restrictive covenant by a successor corporation subsequent to a merger or acquisition may be prohibited in the absence of the employee's consent or express assignment language in the agreement.[17]

Finally, there are practical day-to-day steps that employers should take to further increase the likelihood that a court will enforce a restrictive covenant in the event litigation ensues. These include taking all reasonable steps to protect confidential or trade secret information by securing electronic assets, ensuring such information is marked as confidential, segmenting access to protected information on a need to know basis, limiting third party access absent a confidentiality agreement; and requiring employees to immediately return confidential information upon separation. And, where injunctive relief will be sought, it is imperative that employers act quickly in seeking such relief. Indeed, a court's willingness to enforce a restrictive covenant can turn on whether the agreement was selectively enforced in the past, which can be indicative that the agreement is not necessary to protect the business's interests or of a lack of irreparable harm.[18]

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[15] *See, e.g., Softchoice Corp. v. MacKenzie,* 636 F. Supp.2d 927 (D. Neb. 2009) (promise of continued employment is not valid consideration for a non-compete agreement).

[16] For example, a non-compete is unenforceable in Massachusetts if the employee was laid off or terminated without cause. M.G.L. c. 149, § 24L. *See also SIFCO Indus., Inc. v. Advanced Plating Techs., Inc.*, 867 F. Supp. 155 (S.D.N.Y. 1994 (refusing to enforce non-compete agreement against laid off employees).

[17] *Compare* Fla. Stat. Ann. § 542.335(1)(f)(2) (non-compete enforceable by successor after a merger or acquisition only if expressly authorized by agreement) *with Acordia of Ohio v. Fishel II,* 133 Ohio St.3d 356, 2012-Ohio-4648, ¶¶ 10–16, 978 N.E.2d 823 (holding that post-merger, successor company "may enforce the noncompete agreements as if it had stepped into the shoes of the original contracting compan[y], provided that the noncompete agreements are reasonable.").

[18] Jess A. Dance and William W. Sentell, *Turning an (Occasional) Blind Eye: Selective Enforcement of Franchisee Post-Term Non-Compete Covenants*, 37 Franchise L.J., No. 2 at 245 (Fall 2017).

The foregoing discusses but a fraction of considerations at issue when seeking to enforce restrictive covenant agreements. Although disfavor of non-compete agreements may be growing, there are practical alternatives and steps that employers can take to protect their businesses without resorting to the imposition of unduly burdensome restrictions unlikely to be enforced by the courts.