



Non-compete Agreements with Employees

This Note provides an overview of non-compete agreements between employers and employees. Non-compete agreements may also be referred to as non-competition agreements or non-competes. Non-compete agreements are largely dependent on state law. Although this Note does not address state or local law, the information contained in this resource will be useful and relevant to employers in every state. State-specific surveys will be available to provide state-specific guidance in the near future.

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Vanessa Máire Griffith, Vinson & Elkins LLP

This Note gives a broad overview of non-compete agreements between employers and employees. It focuses on relevant law, drafting and enforcement issues. In particular, it considers:

- The basic function of non-compete agreements, their benefits and their limitations.
- Key issues to assess when creating a non-compete agreement.
- Key issues to assess when seeking to enforce a non-compete agreement.
- Available legal protection as an alternative to, or in the absence of, a non-compete agreement.

WHAT IS A NON-COMPETE AGREEMENT?

A non-compete agreement (also known as a non-competition agreement or a non-compete) is an agreement between an employer and an employee that imposes professional restrictions on the employee after the work relationship ends. Non-competes restrict former employees from working for competitors or defined groups of competitors for a defined period of time. Employers use non-competes to protect their valuable corporate assets, such as trade secrets and good will.

Not all non-competes are enforceable. Enforceability is a question of state law and varies from state to state. Most courts, however, recognize that non-competes severely limit an individual's ability to make a living and will not enforce non-competes that restrict employees beyond what is reasonably required to defend a legitimate business interest.

Benefits to Employers

Non-competes benefit employers by providing greater assurance that the company's intellectual property, confidential resources and proprietary information will not be made available to or used by a competitor. Although confidentiality agreements and state common law also provide protections for intellectual property, those mechanisms do not prohibit former employees from working for a competitor.

Non-competes are particularly useful to employers when the employee who signs the agreement possesses important confidential information or trade secrets. Most employees have some important company knowledge, but it is rare for more than a few employees to have information that, if disclosed, could jeopardize a company's business. Employers should identify employees in this high risk subset and should take particular care to develop useful and enforceable non-competes for them.

Industry-specific Limitations on Non-competes

Non-competes may not be appropriate or enforceable in all industries.

Attorneys

In general, non-competes are not enforceable against attorneys because of ethical prohibitions on preventing clients from retaining the lawyer of their choice. There are limited exceptions. For instance, Ohio authorizes narrow restrictions on the practice of law for retiring attorneys.

Doctors

Many states limit the enforceability of non-competes in the medical profession. In Texas, for example, non-competes with physicians are only enforceable if they meet certain



conditions that are not generally required of non-competes. Among other things, the agreement must provide the doctor with access to certain patient lists and medical records and provide for a buy-out of the agreement at a reasonable price. Colorado similarly restricts the enforceability of non-competes in the medical context.

In states where there is no statutory framework for non-competes, courts have refused to hold doctors to non-competes where doing so would harm the public. This is not true in all states. Illinois, for instance, has held that physician non-competes should not be analyzed differently from those involving other professions and industries (other than law).

Jurisdiction-specific Limitations on Non-competes

There are jurisdictions where non-competes are entirely or largely unenforceable, regardless of the impact that competition may have on an employer's business. Most notably, in California, non-competes are not enforceable if they arise solely in the context of an employment relationship. However, California employers can use other means to protect trade secrets and other information, for example, by using confidentiality and non-disclosure agreements. Non-competes are enforceable in California where they arise in the context of the sale or dissolution of a business.

CREATING A NON-COMPETE

To be enforceable, a non-compete must satisfy the requirements of:

- **Contract law.** In other words, it must be formed through the acceptance of an offer and be supported by consideration.
- **State law specific to non-compete agreements.** For example, the restrictions must be reasonable.

Contract Law Requirements

Consideration

Non-competes must be supported by consideration, which means that the employer must provide the employee with something of value (or suffer a detriment) in return for the employee's promise not to compete with the employer. The question of what consideration will support a non-compete is a recurring and problematic one, particularly when the employment relationship is at-will and when the non-compete is signed during employment.

Offer of At-Will Employment as Adequate Consideration

At-will employment is employment that the employer or employee can terminate at any time, for any lawful reason. A common question in determining whether a non-compete is enforceable is whether the offer of at-will employment alone suffices as consideration for a non-compete. In most jurisdictions, if the non-compete was entered into at the beginning of employment then the employer has provided sufficient consideration by extending at-will employment.

However, in some jurisdictions, extending an offer of at-will employment is not sufficient consideration. For example, in Texas, although non-competes can be enforceable in the at-will employment context, the offer of at-will employment is not sufficient consideration. In particular, the consideration provided by the employer to the employee must be something that gives rise to the public policy justification for enforcing non-competes in the first instance. That is, because the enforcement of non-competes is acceptable only when needed to protect an employer's legitimate business interests, the consideration furnished by the employer for the non-compete must be connected to the business interest. Examples include a promise to provide an employee with confidential information or highly specialized training, both of which are designed to further the specific business interests that are also protected by the non-compete.

Continuing Employment as Inadequate Consideration

Even in jurisdictions where at-will employment constitutes adequate consideration, courts may hold that the contract is unenforceable if the parties entered into the non-compete after employment began. Courts may not enforce a non-compete where the consideration is continuing at-will employment. Once an employee has commenced employment, many courts require that the employer provide the employee with an additional benefit (see *Box, Risks of Having Employees Sign Non-competes After the Start of Employment*).

Traditional Contract Considerations

Non-compete agreements may be vulnerable to challenges common to all contracts as well. For example, a party may challenge a non-compete on one or more of the following grounds:

- Duress.
- Unconscionability.



RISKS OF HAVING EMPLOYEES SIGN NON-COMPETES AFTER THE START OF EMPLOYMENT

Asking employees to enter into non-compete agreements after employment has started is risky for several reasons, including:

- The non-compete may not be enforceable in the state where the employee works.
 - Even if it is enforceable in that state, it may not be enforceable in another state if the employee relocates.
 - Additional consideration may be required to make the non-compete enforceable.
- Lack of capacity.
 - Coercion.

State Law Specific to Non-compete Agreements

All states in which non-competes are enforceable require that the restrictions placed on an employee be reasonable in duration and scope. Courts and state legislatures seek to balance an employer's legitimate need to protect its confidential information with an employee's need to earn a living.

Most states, either in case law or state statutes, articulate this principle: the restrictions on the employee should not be any greater than necessary to protect the employer's legitimate business interests. However, states vary on how they strike this balance depending on governing state law and facts specific to each case. There are very few bright line rules, but the following are useful general guidelines applicable in most states.

Reasonableness of Duration

A few states have enacted statutes that set out presumptions regarding duration. For example, under Florida law, a restraint of six or fewer months is presumptively reasonable whereas one that exceeds two years is presumptively unreasonable. However, it is not unusual to find cases enforcing non-competes for longer periods of two and even three years for sales employees or middle management. Once the duration exceeds three years, courts become more critical.

The evaluation of the reasonableness of a non-compete's duration is influenced by the unique facts of each case. For example, where the employer's concern is with confidential information possessed by its former employee, courts look at how volatile or long-lasting that information is. If the information has value for only a short period of time, then the duration of the non-compete restriction should match that period. By contrast, an executive in possession of the company's long-term strategic plans could reasonably be restricted from competing for a much longer time.

Reasonableness of Geographic Scope

The outermost limits of a reasonable geographic scope are generally determined by the employer's activities. If an employer does business in only one state, a restriction that prohibits an employee from working in other states is almost always unreasonable.

Many states have greater restrictions. For example, in Texas, the geographic scope is determined by the employee's activities, not those of the employer. Normally, an employee who was responsible for a specific geographic region cannot be restricted from competing in other regions where his former employer operates. This does not mean that national restrictions can never be enforceable, it simply means that the employer must show that the employee truly operated on a national scale.

Impact of E-commerce

Geographic restrictions may not make sense for certain types of employees and certain types of businesses. Because of the ability to service customers and perform work using various electronic means, employees may perform services on a nationwide basis without ever leaving one city. In that case, a restriction to the city in which the employee worked may not be fair to the employer. In those cases, employers may be able to rely on a broad geographic scope or, alternatively, limit the employees' activities based on customer lists or non-geographic limitations. For example, a federal district court in Pennsylvania upheld a one-year restraint period and a geographic scope that included all of the US because it involved online transactions that are not geographically confined.

Dynamic or Changing Restrictions

Employers are often tempted to describe the geographic or other restrictions in dynamic terms, for example, by



restricting employees from competing in the region for which he is responsible at the time of his termination or soliciting the customers with whom the employee worked at the time of termination.

Restrictions that depend on circumstances that may vary after execution of the non-compete can be attacked on the grounds that they are too indefinite to be enforced. In some states, these variable contract terms may be unenforceable on their face. For example, in Georgia, non-competes using geographic limits that cannot be established until the end of employment invalidates the agreement.

Reformation of Overbroad Non-competes

Most states permit courts to modify a non-compete that is overbroad but otherwise enforceable to ensure that the restrictions are reasonable. A few states, however, do not permit modification, or "blue-penciling" of non-competes in the employment context. Georgia, for example, subjects non-competes that arise from an employment relationship to strict scrutiny and if any of the provisions are enforceable, the entire non-compete is void. Nebraska is another state in which modification is not permitted.

Although most states allow courts to modify non-competes, there are considerable variations among these states on important issues. Some states require reformation whereas others leave it to the discretion of the court. Some states permit modification only if the agreement contains a severability clause.

Even when an agreement is modified, the fact that the agreement as originally drafted was overbroad can have a significant impact on the parties. For example, a Texas statute requires a court to reform a non-compete that contains unreasonable restrictions of time and scope, provided the agreement is otherwise enforceable. However, if the agreement is overbroad, the employer cannot recover damages for breaches of the agreement that occurred before the reformation.

Provisions to Consider in Drafting Non-competes

Non-competes should be drafted to address the particular circumstances of the employment relationship. Using form non-competes without customization for all employees, regardless of job position, responsibilities, knowledge and access to confidential information can be disastrous because:

- The use of a form is some evidence that the agreement

is not drafted to ensure that it is only as restrictive as necessary to protect the employer's interest.

- There are many provisions that are appropriate for some employees and not for others.

Apart from the considerations of contract law and state legal requirements specific to non-compete agreements addressed above, employers should assess their individual circumstances, existing contract terms and state law when determining whether these provisions are appropriate for their needs or enforceable in their state. The following is a non-exhaustive list of provisions that employers may want to consider when creating non-competes:

- **Tolling provisions.** Employers should consider including a provision that tolls (suspends) or extends the restrictive period during any time that the employee is in violation of his obligations.
- **Prohibition on competition and preparation for competition during employment.** State law generally allows employees to prepare to compete if such preparation does not otherwise violate their duties to their employer. However, an employer can enter into an agreement with an employee in which the employee agrees not to undertake any preparations to compete while employed.
- **Remedies.** Employers should consider establishing their right to obtain monetary remedies and equitable remedies. Some jurisdictions may also allow for contracts imposing liquidated damages.
- **Notification provisions.** Employers should consider requiring a departing employee to disclose his new employer and nature of the new position. This creates an obligation that ordinarily does not otherwise exist and may assist in enforcement. Likewise, consider requiring the employee to provide a copy of the non-compete to any future employer.
- **Garden leave clauses.** If the employer is concerned about enforceability, it should consider a provision that authorizes continuing salary or other benefits during the restriction period. These "garden leave" provisions may expand the circumstances under which a court will enforce the agreement.
- **Arbitration clause.** Employers should consider adding an arbitration clause to the non-compete. Arbitration clauses may be desirable to employers for many reasons. However, when using them in non-competes,



the employer should consider whether it wants a request for preliminary or emergency relief to be handled by an arbitrator or court.

- **Choice of law clauses.** Employers should consider identifying a specific state's law that will govern interpretation of the non-compete. Non-compete law varies by state. A choice of law provision improves the likelihood that the parties' expectations about what law will govern will be enforced. However, the enforcement of these provisions is also subject to much litigation.
- **Venue and forum selection clauses.** Employers should consider adding a venue (or geographic location) and forum (or court or other tribunal) selection clause. A venue selection provision provides greater certainty about where litigation will occur and can enhance the likelihood that the parties' choice of law provision will be enforced.
- **Blue-pencil clause.** Where authorized by state law, employers should consider adding a blue-pencil clause allowing a court interpreting the non-compete to strike out and re-write unenforceable portions of the non-compete.

ENFORCING A NON-COMPETE

Having an enforceable non-compete is only one aspect of a comprehensive and effective plan to protect an employer's confidential information, trade secrets, good will and intellectual property. Employers should also create a process for handling departing employees, developing a protocol for evaluating suspected competitive activities and formulating a plan for appropriate legal action as required.

Departing Employees

When an employee leaves an employer, the employer should remind him of his continuing legal and contractual obligations regarding competition, solicitation and the protection of confidential information. Employers may convey this message through the exit interview process. At that time, the employer should provide the employee with copies of any applicable agreements. If an employer offers a departing employee a severance agreement, that agreement should specifically refer to the continuing obligations outlined in the non-compete and note that these obligations remain binding.

The employer should also consider reminding the employee of his general obligations under the common law of most states to return all company property, including intellectual

property and confidential information, and not to divulge any of this information in the future. Employers can also use this opportunity to learn about the employee's future plans, to the extent they are not already known, and identify potential problems at the earliest possible stage.

The employer should also take appropriate steps to contact customers, vendors and other important business contacts regarding the employee's departure. Although the departing employee may have already made contact or solicited business, the sooner the employer reaches out and frames the message, the less likely it is to lose business. An employer can advise customers of the former employee's contractual obligations, although there is some risk that if the non-compete is not enforceable, the employer could face tort liability for interfering with a legitimate business relationship.

Assessing a Potential Violation

Once an employer becomes aware that a former employee is, or may be violating his non-competition obligations, it is important for the employer to conduct a rapid, thorough and objective evaluation of situation. It is important to undertake this analysis quickly because if the employer seeks an injunction, one factor that courts consider is how quickly the employer acted to preserve its interests. An assessment of potential non-compete violations should include the following factors:

- Is the employee actually in violation of a binding non-compete agreement?
- If so, what harm has the employee caused and what harm is the employee likely to cause in the future?
- Has the employer suffered actual damages, such as the loss of an account or customer, or is the harm speculative?
- If the employer has been harmed, can the damages be quantified or is the harm not easily calculated in financial terms, such as a loss of reputation?
- Is the non-compete enforceable as written? If it is overbroad, will the court modify the agreement and enforce it as rewritten?
- Where would a lawsuit be filed? How favorable a forum is it? How does the forum affect the law likely to be applied?
- What are the costs of litigation, including attorneys' fees, disruption to the business and the impact on customers,



especially those who might become witnesses or called on to produce documents?

Legal Action

Once the employer has evaluated its chances of success in enforcement of the non-compete, both legally and factually, as well as the costs and benefits associated with success or failure, it must decide whether to take affirmative steps to enforce the non-compete. The employer must decide whether to send a cease-and-desist letter or some similar communication or whether to proceed immediately to litigation. Each approach is appropriate in some circumstances, but not others.

Cease and Desist Letters

A cease and desist letter is a preliminary step designed to resolve any disputes regarding the potential breach of a non-compete before it results in litigation. Cease and desist letters:

- Remind employees of their contractual and legal obligations.
- Advise employees that their former employer believes that they breached those obligations.
- Advise employees of the employer's anticipated course of conduct if the breach continues.

The letter typically concludes with a demand that the employee ceases the unlawful conduct and provides appropriate written assurances of compliance.

Advantages of cease and desist letters include:

- **Information gathering.** If the employer is not certain of the extent of the former employee's misconduct, this type of letter usually elicits a defensive response explaining how the former employee's activities are consistent with his non-compete obligations. Alternatively, the response may concede violation but argue that the non-compete is unenforceable. The former employer almost always knows more than it did before sending the letter.
- **Possible litigation avoidance.** If the employer is hesitant to start litigation, contacting the former employee and trying to reach a resolution of the dispute is worth the effort.
- **Extends the timeline for legal action.** The letter buys the employer time because it demonstrates the employer's intent to protect its interests without having to file suit.

Employers should also consider sending a similar letter to the former employee's new employer notifying it that its new employee is bound by a non-compete and explaining how the employment of the former employee may unlawfully interfere with that agreement. This approach has some risks. For example, if the employee is fired from his new employer because of this letter, but the agreement is invalid, the employee may have a claim for tortious interference with contract.

Litigation

An employer may forego the cease and desist letter in favor of immediate litigation. The following may make this a reasonable option:

- The damage to the business may be too great or the damages too significant to delay enforcement.
- The employer may want the tactical advantage of surprise to enhance the likelihood that the employee will not destroy documents or take other evasive action.

In filing suit to enforce a non-compete, the goal is typically to obtain injunctive relief. Although employers may also hope to recover damages, it is usually far more important to obtain an immediate injunction that enforces the agreement or otherwise preserves the circumstances as they existed before the violation of the non-compete.

The standard for obtaining any injunction varies from state to state but is usually a variation of the following elements:

- The employer is likely to prevail on the merits of the case at trial.
- The employer has or will suffer irreparable harm; that is, harm that cannot be remedied through the payment of money.
- The balance of harm faced by the employer compared with the harm the former employee could suffer through issuing the injunction favors the injunction.
- The public interest is not adversely affected by the issuing a preliminary injunction.

It is within a judge's control and discretion to determine whether the standard for an injunction has been met, and employers often have a difficult time meeting the standard. Employers may seek the following injunctive relief:



- **Temporary restraining order (TRO).** A TRO is an order that is typically very short in duration and that specifies what a party can or cannot do during its duration. Typically, the grant of a TRO is not appealable so, at a minimum, the parties must live with the decision to grant or deny the TRO for a period of several weeks before the temporary or preliminary injunction stage.
- **Preliminary injunction.** A preliminary injunction is an order that specifies what a party can or cannot do during the term of the order. It is typically designed to last for the period up until the parties go to trial in their dispute. As a result, while they have a specific duration, they nonetheless extend for several months. Preliminary injunctions are immediately appealable in most jurisdictions but the delays attendant to appeals, even expedited appeals, mean that the parties will also have to live with this ruling for much of the term of the non-compete at issue.
- **Agreements not to solicit clients.** Legal evaluations of agreements not to solicit clients, in most but not all jurisdictions, are conducted similarly to legal evaluations of non-competes.
- **Agreement not to hire employees or recruit employees.** These types of agreements are typically not subject to the same rigorous standards as non-competes and are enforceable based on ordinary contract law.
- **Confidentiality agreements.** These agreements do not contain non-compete provisions but do define the scope of protected information and prohibit its use.
- **Assignment of invention agreements.** These agreements are particularly useful and important for employees who are directly involved in the development of the company's intellectual property.

Employers seeking injunctive relief must undertake litigation fully prepared to present a compelling case regarding the need for that relief. Employers should recognize that seeking an injunction requires a tremendous amount of work for a brief period of time. An ordinary breach of contract suit may linger for years but a suit to enforce a non-compete with injunctive relief may be resolved, at least through the preliminary injunctive phase, in a matter of weeks or months.

Litigation is risky and expensive but may be necessary to ensure that a company's trade secrets, confidential information and goodwill are protected. The best way to accomplish this objective is to:

- Draft an enforceable agreement.
- Advise departing employees of the consequences of violations.
- Quickly and thoroughly evaluate the best course of action in the event of a breach.

ALTERNATIVES TO NON-COMPETES

Related Agreements

Non-competes are not the only option for protecting confidential company information. Other agreements that may be considered, either in addition to or instead of non-competes include:

Protection in the Absence of Non-competes: Inevitable Disclosure

The inevitable disclosure doctrine (or inevitable misappropriation doctrine) is based on the theory that, for some employees, the nature of their new position would require that they share the previous employer's trade secrets. Most often, the inevitable disclosure doctrine arises after an employee who is not bound by a non-compete joins a competitor. The former employer may attempt to protect its trade secrets by asserting that there is an implied non-compete because the former employee will unavoidably disclose sensitive information.

- The doctrine of inevitable disclosure is not recognized in all states. For example, although New York has recognized it, California has rejected it. Even where recognized, the doctrine requires a higher degree of proof to obtain the same relief available for an enforceable non-compete. The primary factors that courts consider when analyzing the risk of inevitable disclosure of trade secrets are:
 - Whether the former and new employers are direct competitors.
 - The degree of similarity between the employee's new job and the old job.
 - The value of the trade secrets at issue to both the new employer and the previous employer.