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More Scrutiny Seen for Noncompete Agreements

By Gayle Cinquegrani

Employers that rely on noncompetition agreements to discourage employees from swiping trade secrets and copying customer information when they leave the job must craft those documents carefully to assure they can withstand scrutiny by the courts.

“Courts seem to be increasingly strict at enforcing covenants not to compete,” said Ken Carlson, a partner at Constangy, Brooks, Smith & Prophete in Winston-Salem, N.C. “It’s getting more challenging to enforce them,” he told Bloomberg BNA May 3.

“It is still a very vibrant area of law, if done correctly,” Carlson said. There is “tremendous pressure to protect against unfair competition” because modern technology allows “information to be shared in a nanosecond,” he said, with employees able to download data from an employer’s computers onto a flash drive or send it to their personal e-mails. “Courts require the drafters to get it right.”

“It’s going toward continued but more restricted enforcement with companies having to take extra measures to do it in the right way,” Carlson said. Courts and lawmakers are exerting increasing “pressure to more narrowly define and protect legitimate business interests in a way that doesn’t prohibit normal competition.”

The future attitude toward noncompetes “is anybody’s guess because of the change in administration,” Ed Carlstedt, a partner at Ford Harrison in Tampa, Fla., told Bloomberg BNA May 1.

Adopting Additional Safeguards

Even though state rather than federal law controls these agreements, Carlstedt said many states adopted “additional safeguards for employees” in response to a call to action by the Obama administration in 2016.The White House encouraged state legislatures to regulate the use of noncompetes and ban them altogether for low-wage workers.

“People don’t know if the Trump administration is going to be more or less favorable to noncompetes,” although many assume it will be more receptive to them, Carlstedt said.

“Lawmakers don’t like” noncompetes, Terese Connolly, a partner at Culhane Meadows in Chicago, told Bloomberg BNA May 1. She said many states have limited these documents during the past few years.

The Illinois Freedom to Work Act, which took effect in January, prohibits noncompetes for low-wage workers in the private sector. Legislatures in several states—including Maryland, Utah and Idaho—have been considering limits on noncompete agreements, she said.

California doesn't permit any noncompetes in the employment context, but "the vast majority of states allow them to some degree," Todd Newman, a lawyer in Salisbury, Mass., told Bloomberg BNA April 28. "There's a lot of momentum out there" to "try to change noncompete law to make it less restrictive for employee mobility," he said.

There is "a focus nowadays on really tailoring the restrictive covenants and only using them for employees who have access to trademark or proprietary information or big customer relationships," Connolly said. Recent trends include limiting their applicability toward low-wage workers, "their temporal scope" and the type of activities they prohibit.

Reasonableness of Scope

Noncompetes "generally must be reasonable in scope as to time and geography and the scope of the activity they're covering," Newman said. "If your noncompete is overbroad, you really run a risk that it won't be enforced," he said. "Some courts will invalidate the entire noncompete" if one provision is overbroad, while courts in other states will modify it to preserve the acceptable provisions." A court will look at the totality of the circumstances" when deciding whether and how to enforce a noncompete agreement, Connolly said. "If you only protect your legitimate interests, you're probably not going to have any problems."

With noncompetes, courts may consider factors outside the four corners of the contract and use a "balance of hardships test," Newman said. They may decide to set part or all of a noncompete aside if they find that "the hardship that will fall on the employee will be so great" that it outweighs the harm to the employer.

An example could be if an employee who is the sole breadwinner for a large family would have to move out of state to find a new job. "Courts look at these on a case-by-case basis," Newman said. "Employers would be wise to craft them as narrowly as they can to meet their legitimate business needs."

In some cases, employers could use a less burdensome restriction than a noncompete. Newman said a nonsolicitation-of-clients agreement would serve some employers' needs, and Carlstedt said many employers could use a confidentiality agreement that allows a former employee to take a new job without appropriating the former employer's confidential information, such as client lists.

Onboarding Process

Savvy employers pay attention to the process they use for introducing noncompetes. Some states, such as New Hampshire, require an employer to present the noncompete to a job applicant before he accepts a job offer. Newman suggested including the noncompete agreement with the offer letter. If an employer wants an employee to sign a noncompete after he has been in the job for a while, the "employer is wise to offer something above continued employment" in exchange for the employee's signing, such as a bonus or a raise, he said.

If a noncompete agreement appears to have been violated, the employer's lawyer could send a "cease and desist letter" to the employee. An employer also could sue for monetary damages and an injunction that prevents the employee from working, which could cause the new employer to fire the employee. "If you violate a noncompete, you might be drawn into a legal process that is time-consuming and costly for you but which can affect your whole family," Newman said.

Employers that are filling a job vacancy can try to fend off a potential controversy by asking job candidates if they're covered by a noncompete. "As part of the onboarding process, you always want to have that clause that warrants that he has no restrictive covenant that would prohibit him or her from working at Company A where they're being hired," Connolly said.

Newman said a company could include language in an employment contract stating that it doesn't want a new employee to bring any trade secrets with him from a prior employer. "That's how an employer protects itself," he said.

Terese Connolly is an experienced employment and labor law partner in the Chicago office of Culhane Meadows PLLC, where she provides advice and counsel to domestic and multinational corporations managing diverse and global workforces. Connolly conducts enterprise risk assessments, compliance audits, internal investigations, and trains management and employees on employment law, leave laws, anti-discrimination and harassment, diversity, and domestic and international labor and employment law compliance.