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NONCOMPETITION AGREEMENTS

Noncompete agreements are on the rise, especially for lower-level jobs, Dykema attorneys Jill S. Vorobiev and Amy Jonker say in this BNA Insights article. A carefully drafted noncompete agreement can protect an employer, but a ''one-size-fits-all'' agreement may end up costing an employer legal fees, employees, valuable business information, and clients, they say.

The authors discuss how tailoring a noncompete agreement to the legitimate business interests in need of protection is crucial to successful enforcement in court. Although an overly broad noncompete may have served as a deterrent in the past, an agreement customized to the interests needing protection may better guard the employer's interests without harming the employee, the two attorneys say. And should it be necessary, they add, such an agreement may ultimately prove more likely to stand up in court.

Effective Noncompete Agreements Require Careful Crafting by Employers

BY JILL S. VOROBIEV AND AMY JONKER

Noncompete agreements are under fire across the country by courts and state legislatures that claim the agreements stifle innovation and discourage entrepreneurship. New Hampshire, New Jersey, Massachusetts, and Minnesota are just a few of the states that recently have passed or are expected to pass laws limiting the enforceability of these agreements.

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A noncompete agreement, as the name suggests, restricts the ability of an employee to compete with a former employer upon termination of the employment relationship. Employers use these agreements to prevent employees from working for a competitor within a certain geographic area and for a set duration.

The agreements provide employers with repose knowing that former employees cannot easily misappropriate the employer's customers, confidential information, or trade secrets for the benefit of a competing entity. Noncompete agreements also can assist in the retention of valuable employees a company has invested time and money in training and educating over the years.

But some think that noncompete agreements are counterproductive because they can have the effect of suppressing employee motivation and creativity, creating a barrier to attracting talented employees, hampering mobility, and hindering entrepreneurship and free markets.

A company that enforces a noncompete agreement may develop a reputation as an intimidating, litigious and undesirable company for which to work. Prospective employees who find out they have to sign an overly

broad noncompete agreement may decide not to join that company. Enforcement of noncompete agreements may also create disincentives for current employees to fully develop their talents or business connections.

Noncompete Agreements on the Rise, Especially for Lower-Level Jobs

Despite the recent push in some sectors for limits on noncompete agreements, an increasing number of employers use and enforce these agreements, as evidenced by a 60 percent increase over the past decade in litigation against departing employees over alleged violations of noncompete agreements.

What is the trend attributable to? One new school of thought is that, at least in part, this uptick may be due to more companies using noncompete agreements for employees in a wider panoply of professions.

Noncompete agreements in the past typically were most often thought of as a device to retain higher-paid executives and professionals who, in turn, were able to negotiate greater compensation in exchange for keeping company secrets and not spring-boarding to a competitor.

As access to sensitive business information and mobility increased among lower-level employees, companies have expanded their use of noncompete agreements to ensure protection of their intellectual property and customer base. Tech companies especially are known for utilizing noncompete agreements for low-level employees to keep their projects under wraps.

Now, more frequently, companies also are using noncompete agreements in non-corporate service-related professions including, for example, jobs such as chefs and event planners. Employees who have critical information, skills, or relationships that could make or break a company's ability to compete in a certain industry are being prevented from taking the company's competitive edge elsewhere by being required to sign noncompete agreements.

The trend has spread to seasonal and part-time employees, such as camp counselors and yoga instructors, and commission-based jobs such as hairstylists. With noncompete agreements proliferating in many professions, employers and employees increasingly need to be acutely aware of the legal and practical consequences of these agreements.

How Noncompete Agreements Work

A well-drafted noncompete agreement will appropriately restrain the employee from unfairly competing against the former employer in such a way that the employee would inappropriately divulge company secrets, take clients, or join a direct competitor in the same or similar capacity after receiving valuable training and information from the employer.

An overly broad or otherwise poorly drafted noncompete agreement can accomplish the exact opposite result. For example, if the noncompete agreement exceptionally constrains an employee, a court may find it unenforceable. That may in turn suggest to other employees that the noncompete agreement is unfair or ineffective and that they too can leave for greener pastures.

The most effective noncompete agreement is one that an employee will not risk violating because it is narrowly tailored to the interests the employer is seeking to protect, provided in exchange for valuable consideration, and understood as reasonable by the employee entering into it. If the noncompete agreement is well crafted, the employee should understand its limits and why those limits are fair.

Simply having an employee sign a noncompete agreement, however, is only the first step. If the employee leaves the company to work for a rival in violation of the agreement, the company may still need to sue the employee in order to enforce the noncompete agreement.

The need to pursue litigation may be less likely with respect to higher-level employees, who may be more likely to review and negotiate their noncompete agreements, signaling their understanding and acceptance of them. But lower-level or non-corporate employees or seasonal or part-time workers may not be expecting a noncompete provision in their offer letters or employment agreements and therefore may not fully understand what the restriction prevents them from doing. This can lead to difficult and contentious legal battles over whether the noncompete agreement is fair and enforceable.

Making Noncompete Agreements More Effective

The increased litigation over noncompete agreements shows that employers are suing more frequently. But are the employers winning those lawsuits? Not necessarily.

Suing a lower-level or nonprofessional employee exposes the employer to litigation costs and can result in unsuccessful outcomes. Many courts seemingly are more hesitant to enforce noncompete agreements against these employees and more likely to uphold agreements entered into by ''professionals.''

Courts have found that these nonprofessional employees may have limited or no access to truly sensitive information, client lists, or trade secrets, and may have received little on-the-job training or education that would give a competitor who hires them an unfair advantage.

When ruling on the enforceability of a noncompete agreement, one of the court's considerations may be the employee's right to work and pursue a livelihood and

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whether the noncompete agreement would impose an undue hardship on the employee.

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This makes noncompete agreements for lower-paid employees somewhat risky, especially in situations in which insufficient consideration is given to them in exchange for their agreement not to compete.

For example, in *McKasson v. Johnson*, 315 P.3d 1138, 37 IER Cases 795 (Wash. Ct. App. 2013), the court refused to uphold a noncompete agreement against an exercise instructor who went to work for a competing gym.

Will McKasson was an at-will employee at a gym earning $16 an hour for teaching group and individual exercise classes. Five years into his employment, he was asked to sign a contract stating that he would remain an at-will employee at $16 per hour but then would be subject to a noncompete agreement preventing him from working for a competitor for three years.

The noncompete agreement also explicitly stated that the gym was not providing him any consideration for the noncompete agreement other than continuing his at-will employment.

The court found the noncompete agreement legally unenforceable. ''Valid incorporation of a noncompete clause requires the employer to give the employee consideration in exchange for the employee's employment restriction; consideration in this context is an employer's promise to do something for the employee or to give the employee an additional benefit in exchange for the employee's agreement to the restriction . . . [W]hen an existing at-will employee agrees to a noncompete restriction sometime after he or she was hired, the restriction is enforceable only if the employer gives the employee independent consideration at the time of their agreement.'' *Id*. at 1141.

The takeaway: Be sure that your company is offering adequate compensation to employees in exchange for signing noncompete agreements. Failing to do so can leave the employer with an unenforceable contract and substantial litigation costs.

Another consideration with respect to these employees, particularly those who work in places such as gyms, camps or hair salons, for example, is the risk that unfavorable publicity from an unsuccessful lawsuit could compromise the reputation of the business in the local community.

Additionally, even if the employer were successful in litigation against a departing employee, it would be unlikely that the employee would have the financial resources to pay any monetary judgment the employer might obtain. Thus, regardless of the outcome of the litigation, the employer could potentially be worse off financially in these cases.

Regardless of the employee's position, however, there are certain steps employers can take to increase the likelihood that an agreement will hold up in court. Most courts simply will not enforce a noncompete agreement if it is not ''reasonable.''

What makes a noncompete agreement ''reasonable''? The answer is that it depends on what the business involves and who the employee is. A carefully drafted noncompete agreement can protect an employer, while a ''one-size-fits-all'' noncompete agreement may end up costing an employer legal fees, employees, valuable business information, and clients.

Tailoring a noncompete agreement to the legitimate business interests in need of protection is crucial to successful enforcement in court.

How should an employer draft an effective noncompete agreement and what type of agreement should an employee sign? *First*, it should be customized to the specific circumstances of the employee, the position, the company, and the industry. Depending on the type of employee, the profession, and the jurisdiction, courts analyze noncompete agreements differently.

The noncompete agreement should contemplate the specific parameters of the employee's job responsibilities, access to sensitive information, and contact with clients. The geographic restraint should be compatible with the employee's location and the type of business, and the duration ought to be relevant to the profession and industry.

For example, in a recent Illinois case, a noncompete agreement was upheld against an employee who prepared tax returns from January through April.[1] The employee signed a two-year noncompete agreement that prohibited him from preparing taxes for any client the employee prepared taxes for while he was working for the employer. The court found that the ''limited restrictions, in terms of the prohibited activity and duration, in context of the totality of the circumstances, [were] reasonable and enforceable and sufficient to protect plaintiff's business interest.''

On the other hand, courts generally will not enforce noncompete agreements against employees who do not have meaningful access to or use of confidential information, including client lists. For example, in *Ecology Services, Inc. v. Clym Environmental Services, LLC*, 181 Md. App. 1, 27 IER Cases 1704 (2008), Ecology Services had two contracts with the National Institutes of Health. When a competitor obtained the bid for one of the contracts, several employees, including radioactive waste specialists, left Ecology Services to work for the competitor even though they had signed noncompete agreements. The appellate court affirmed the trial court's decision not to enforce the noncompete agreements, because the employees were ''clearly low level employees not utilizing skills against whom covenants not to compete could be enforced,'' and the employees did not solicit customers or take private customer lists or assigned routes.

In *Home Paramount Pest Control Cos. v. Shaffer*, 282 Va. 412, 33 IER Cases 46 (2011) (220 DLR A-17, 11/15/11), Home Paramount Pest Control Companies required an individual to sign a noncompete agreement

[1] *Zabaneh Franchises, LLC v. Walker*, 972 N.E.2d 344, 345 (Ill. Ct. App. 2012).

that prevented him from working for two years in certain counties where it operated in pest control generally . The employee later quit and went to work for a competitor, and Home Paramount Pest Control Companies sued him for violation of the noncompete agreement.

The court found that, although the geographic region and duration of the noncompete agreement were both reasonable and narrowly tailored, the broad scope of the noncompete went too far.

The agreement prevented Shaffer from ''engaging even indirectly . . . in the pest control business, even as a passive stockholder of a publicly traded international conglomerate with a pest control subsidiary.'' The lesson: Tailor the description of exactly what activity your company is trying to restrict because an overly broad description could leave you with an unenforceable noncompete agreement.

Second, the agreement should comply with state law. Noncompete agreements are governed by state law. So, to be enforceable, a noncompete agreement must be tailored to fit the requirements of that state.[2]

Not all states have the same laws when it comes to noncompete agreements, but many states follow some form of the ''rule of reason'' approach, asking questions such as: (1) Is the restraint on the employee greater than what is needed to protect the employer's legitimate business interest? (2) What is the hardship on the employee? and (3) What is the likely injury to the public?

If the employment relationship is governed by the law of a state that follows this rule, the scope of the noncompete agreement should sufficiently protect the company but not overstep appropriate bounds lest it be flung out of court completely.

Not every state follows the ''rule of reason'' to the letter. Some states have stricter laws limiting noncompete agreements. In Florida, for example, noncompete agreements must be reasonable but there are slightly different standards for determining what is reasonable. Specifically, the employer must prove a ''legitimate business interest'' to justify the noncompete agreement, which includes confidential business information, a ''substantial relationship'' with customers or clients, or client goodwill in a specific geographic location.

In New York, courts had over the years made it difficult for employers to enforce noncompete agreements when the employer has terminated the employee without cause, so laying off an employee could result in the employee going to a competitor or starting a new competitive business. In Texas, a noncompete agreement cannot be a stand-alone contract but must be ancillary to another agreement, and physicians are exempt from noncompete agreements in certain circumstances.[3]

California, on other hand, does not permit enforcement of noncompete agreements and considers them ''void.''[4] Employers can, however, utilize nondisclosure agreements, which require employees to maintain the confidentiality of trade secrets and sensitive business information after the employment relationship has ended.

Other states have unique statutory requirements and restrictions for noncompete agreements, including North Dakota, Oregon, and Oklahoma. These are just a few examples of the differences in state law in relation to noncompete agreements.

Changes in the Law for Noncompete Agreements

What is evident even among these divergences is that the legal landscape for noncompete agreements is constantly changing. Illinois is a recent example. Last year, in *Fifield v. Premier Dealer Services, Inc.*, 993 N.E.2d 938, 35 IER Cases 1826 (Ill. Ct. App. 2013), the appellate court held that if the only consideration provided by the employer in exchange for signing a noncompete agreement is the employment itself, either as a new job or continued employment, then the noncompete agreement is unenforceable until the employee has worked uninterrupted for at least two years.

Following *Fifield*, two judges from the U.S. District Court for the Northern District of Illinois have come down on opposite sides of the decision. Specifically, the court in *Montel Aetnastak, Inc. v. Miessen*, No. 1:13-cv-03801 (N.D. Ill. Jan. 28, 2014), declined to follow *Fifield* and establish a bright-line rule regarding what constitutes sufficient consideration for a noncompete, while the court in *Instant Technology, LLC v. DeFazio*, 2014 BL 126166, 38 IER Cases 427 (N.D. Ill. 2014), followed *Fifield* and rejected the *Montel* decision.

Even in the states that follow the ''rule of reason,'' it can still be difficult to predict whether a court will enforce the agreement due to the variations and different exceptions that appear in each state.

If a noncompete agreement is narrowly tailored to protect the actual business interests of the employer rather than designed to merely restrict competition, noncompete agreements applied to non-corporate, lower-paid employees may be upheld.

As shown in cases in Maryland and Florida, noncompete agreements may still be enforced against ''nonprofessional'' employees in order to protect the employer from losing its customer base. For example, the Maryland Supreme Court found a citywide and surrounding counties area restriction preventing a former camp counselor from working at a competitor for two years to be reasonable on its face, because the counselor had developed close relationships with students who were potential campers, their parents, and others in the field.[5]

Similarly, in Florida, a hair salon's noncompete agreement with a hair stylist was upheld.[6] There, the court reasoned that the agreement was intended to protect the salon's ''goodwill and substantial relationship with its customers and geographic marketplace.''

On the other hand, a court in Illinois declined to enforce a one-year, five-mile limitation against a stylist, finding that there was no legitimate business interest where the key relationship was between the stylist and

[2] *See Sylvan Learning, Inc. v. Gulf Coast Educ., Inc.*, M.D. Ala., No. 1:10-cv-450 (Oct. 6, 2010) (citing *In re Southeast Banking Corp.*, 156 F.3d 1114, 1121 (11th Cir. 1998)) (''The interpretation and enforcement of a noncompete clause in a contract is controlled by state law.'').

[3] Tex. Bus. & Com. Code § 15.50(a).

[4] *See* Section 16600 of the California Business & Professions Code.

[5] *Millward v. Gerstung Int'l Sports Educ., Inc.*, 268 Md. 483 (1973).

[6] *JonJuan Salon, Inc. v. Acosta*, 922 So. 2d 1081, 1084 (Fla. Dist. Ct. App. 2006).

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her clients, rather than between the salon and the clients of the salon.[7]

Considerations for Employers and Employees

What if you are on the other side, trying to hire someone who signed a noncompete agreement with a former employer? Be sure to get a copy of the noncompete agreement and carefully review it to determine whether the restrictions apply to your business.

Are the businesses actually competitors? Do they cover different geographic areas? Would the employee be working in the same capacity or have different job responsibilities? Could you hire the employee for a different position for the duration of the noncompete period? Did the competitor give the employee fair consideration for signing the noncompete agreement or did it force the employee to sign with threats of termination?

Also, consider that if the competitor chooses to enforce it, the legal action could cost your company attorneys' fees and could result in an injunction preventing the employee from working for you. The competitor could sue your company for tortious interference with contractual relations, and ask for damages against your company.

If, after assessing the risk, you decide to hire the employee, consider an offer of employment in writing that would not violate any restrictions, such as prohibiting the new employee from bringing any trade secrets, client lists, property or confidential information from the former employer, or defining the position as not permitting solicitation of business from the competitor's customers. Also, you should consider whether it makes sense to negotiate with the competitor to have the employee released from the noncompete agreement.

Regardless of the employee's position in the company, when leaving a job, the departing employee should avoid compromising enforceable commitments made to the employer at all costs. The employee should work with the former employer to ensure that all confidential documents and information are returned to the employer in the manner desired by the employer.

Employees may have flash or thumb drives containing information that they inadvertently have forgotten about, and only through a thorough discussion of these types of issues can the employer and the departing employee gain an understanding of where this information resides and their presumably shared interest in ensuring its return.

Given the fact and jurisdiction-specific nature of noncompete enforcement and the evolving law in this area, it is important to ensure that any noncompete agreement is appropriately tailored and will withstand judicial scrutiny. While an overly broad noncompete in the past may have served a deterrent effect, parties today understand that a more narrowly drafted agreement that is appropriately customized to the interests in need of protection may better serve to protect the employer's interests without harming the employee, and ultimately prove more likely to stand up in court.

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[7] *Mary Hafferkamp, d/b/a Mary's Shear Artistry v. Leah Llorca*, No. 2009 CH 1038 (Ill. App. Ct. 2013).