Dealmaker Counsel

Employer Beware: Is Your Noncompete Agreement Enforceable?

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Employers routinely require employees to enter into noncompete and nonsolicitation agreements upon commencing employment in order to protect confidential information, trade secrets, and business relationships from being used for competitive advantage. Once an employee executes noncompetition and nonsolicitation covenants (often referred to as restrictive covenants), many employers assume such information and relationships will be legally protected after the employee separates from employment. This is not necessarily the case.

Laws regarding noncompete and nonsolicitation agreements vary from state to state. This article focuses on restrictive covenants entered into in the employment context. In addressing this topic, it is important to draw a clear distinction between restrictive covenants entered into in the employment context and those entered into in the sale of business context (which are typically subject to less scrutiny because they are viewed as necessary to protect the goodwill purchased by the buyer). While several jurisdictions generally support reasonable restrictive covenants in the employment context, a number of others strictly limit an employer's ability to restrict the actions of departing employees. Certain of those states imposing particularly strict limitations are briefly addressed below.

In California, a state that is widely recognized as employee—not employer—friendly, noncompetition agreements in the employment context are invalid and unenforceable. Further, nonsolicitation covenants are subject to very strict limitations that allow the employer to protect against only the use of the employer's trade secrets in soliciting customers post-termination of employment. Similarly, North Dakota, Oklahoma and Montana law also contain strict provisions regarding restrictive covenants in the employment context. North Dakota law explicitly prohibits noncompetition agreements by statute; the North Dakota Supreme Court has also determined that agreements prohibiting the post-employment solicitation of customers are invalid pursuant to this statute. Oklahoma law bars noncompete agreements, though an exception exists allowing an employer to prohibit former employees from directly soliciting the sale of goods, services, or a combination of goods and services "from the established customers" of a former employer. Montana's noncompete statute generally prohibits restrictive covenants in the employment context. Despite this prohibition, however, Montana has upheld restrictive covenants contained in employment agreements under certain narrow factual circumstances.

Several other states also severely restrict the scope of such agreements. Colorado law, for example, limits

covenants not to compete in the employment context to: (1) executive and management personnel and officers and employees who constitute professional staff to executive and management personnel; (2) contractual provisions providing for the recovery of the expense of educating and training an employee who has served an employer for less than two years; and (3) contracts for the protection of trade secrets. Restrictive covenants not falling within the statutory exceptions are void under Colorado law.

In Louisiana, noncompete and nonsolicitation provisions are only valid if limited to a specified parish or parishes, municipality or municipalities, or parts thereof, as long as the former employer carries on a like business therein, and the covenant does not exceed two years from termination of employment. Similarly, South Dakota law provides that an employee may agree with an employer not to directly or indirectly engage in the same business or profession as his/her employer for a period not to exceed two years, or to refrain from soliciting existing customers of the employer within a specified county, municipality or other area for a period not to exceed two years from termination, if the employer carries on a like business therein.

A few states, like Wisconsin, Nebraska and Arkansas, allow reasonable noncompetition and nonsolicitation agreements, but will simply invalidate an agreement entirely if a court determines the agreement is not reasonable. These states, along with some others, generally refuse to modify or otherwise reform agreements determined to be overbroad in scope. In such states, it is particularly important to narrowly tailor noncompetition and nonsolicitation covenants in order to maximize the likelihood of enforcement.

With the above as brief background, it should be clear there is no "form" noncompetition or nonsolicitation covenant that will pass muster in every state. Employers should carefully consider an employee's position, the interests the employer desires to protect, and the state in which the employer and employee reside in crafting restrictive covenants for a particular employee. The failure to do so may result in severe and damaging business consequences.

Is your noncompete enforceable? Employers are encouraged to contact qualified legal counsel to assess the enforceability of current agreements with employees and before drafting new agreements in order to increase the likelihood that such agreements will be enforceable.

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