Locking Up Employees with Non-Compete Agreements

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Can a company really keep its employees from going to work for a competitor? Can it keep employees from calling on or working with the company's customers after employment ends? The answer may surprise you: it depends.

There is no national non-compete or non-solicitation statute. Each state regulates non-compete and non-solicitation agreements in special and unique ways. Although 47 states have enacted versions of the Uniform Trade Secrets Act—all except North Carolina, New York and Massachusetts—interpretation and enforcement of these so-called "uniform" laws can vary from state to state and even from court to court within the same state. (Texas is the latest state to adopt the law, effective September 1, 2013.)

This means a company's ability to restrict employees' competitive conduct after their employment ends, and those employees' ability to take actions against their employers' interests, will depend on the specific facts and the state law applicable to their relationship.

No uniform standards for what makes a non-compete agreement enforceable

Broad employee covenants not to compete are viewed by many states as against public policy and are frequently reformed or found to be unenforceable altogether. For example, in California and North Dakota, non-compete agreements are generally void as a matter of public policy when used in the employment context. In other states like Texas, a non-compete and non-solicitation agreement likely will be found enforceable if the employee is given adequate consideration to support the agreement (like access to trade secrets or participation in an equity plan) and the scope of the restrictions is reasonable.

Non-compete and non-solicitation agreements must be drafted with care to withstand judicial scrutiny.

Many states treat non-compete and non-solicitation agreements identically, while others view them differently. In all cases, non-compete and non-solicitation agreements must be drafted with care to withstand judicial scrutiny.

There is no standard "one-size-fits-all" agreement which will fully protect a company and be enforceable against all types of employees and conduct in all 50 states. Because the laws governing restrictive covenants vary from state to state, each agreement should be evaluated individually, paying close attention to business circumstances, the employee involved and state law.

Although there are many state-specific variations, most state and federal courts look at the following factors in determining the validity of restrictive covenants:

• ***Reasonableness:*** Courts will look to see if the employer has a legitimate business interest in protecting the time, investment and other resources that it has expended in training employees or developing trade secret or other proprietary information. The employer's business interest must be balanced against the employee's right to pursue work elsewhere. It is important that an employer not unduly limit an employee's other work opportunities or activities. The employer bears the burden of proving that the agreement is narrowly tailored to protect its legitimate business interests. Any ambiguities in the contract will likely be directly or indirectly construed in favor of the employee.

• ***Duration:*** Restrictions generally must be reasonably limited in time. Agreements containing a one- or two-year post-employment restriction on employment or solicitation of customers are often found to be of "reasonable" duration in the energy sector. Those extending beyond a two-year time period will be scrutinized more closely. In some states like Louisiana, duration may be limited by statute.

• ***Geographic Scope:*** Restrictions should also be limited to a reasonable geographic scope. For instance, if an employer does business in a particular area, courts usually refuse to enforce agreements that extend beyond that area. If an employee's job duties were limited in geographic scope, and his/her access to the company's proprietary information was limited in geographic scope, a court may find restrictions on competition beyond this geographical scope to be unenforceable. It is important to "narrowly tailor" the geographic reach of agreements to the circumstances. Some states have specific technical requirements; for example, Louisiana requires a non-compete agreement to name the specific parishes (or counties) it is intended to cover.

• **Activity:** Courts consider the categories of restricted "activity." Courts may find an agreement overbroad if it does not specify that an employee is precluded from engaging only in the specific work the employee performed for the former employer. Thus, an agreement that attempts to preclude an employee from working in a business area to which he had no connection during employment may be deemed overbroad and unenforceable.

• ***Consideration:*** Restrictive covenants generally must be supported by valid consideration (i.e. something of value received in exchange for the covenant). In some states, a non-compete agreement is supported by sufficient consideration if it is entered into at the time an employment relationship begins. In that instance, the employment itself may serve as the consideration. On the other hand, courts in other states will not enforce a non-compete provision unless the employee receives "independent" consideration—something of value, other than continued employment—in exchange for signing the agreement. In those jurisdictions, when a non-compete agreement is entered into after an employee's initial hire date, the agreement likely must be supported by a bona fide employment benefit, i.e., a promotion, a raise, stock options, access to new confidential information, etc. Without such consideration courts may deem the covenant void for insufficient consideration. The employer must do it right under the applicable state law. In Texas, for example, giving an employee money to sign a non-compete is generally invalid consideration, but giving the employee access to the employer's confidential information during employment likely is valid consideration.

In sum, courts in most states will enforce a non-compete agreement only if it is (1) part of or tied to an otherwise valid agreement or relationship (i.e., employment); (2) necessary to protect a legitimate interest of the employer (i.e., a trade secret, confidential information, or

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truly specialized training); and (3) reasonably limited in its temporal, geographic and activity scope. Some states like California or North Dakota may not enforce a non-compete agreement regardless of how it is drafted.

Different approaches to handling overbroad non-compete agreements

What happens if an agreement is too broad in scope? It depends on which state's law applies. Courts around the country use different approaches to address overbroad restrictions. Some courts will modify an overbroad agreement to enforce it more narrowly. Some courts strike the overbroad non-compete provision but enforce the rest of the parties' agreement. Other courts refuse to modify overbroad agreements and find them totally unenforceable in their entirety.

• ***Reasonable Modification:*** The first judicial approach is the "reasonable modification" approach. Under this theory, courts may "rewrite" an overly broad agreement to make it more narrow and enforce it as rewritten. In so doing, courts make a determination on the particular facts and limit the restrictions as necessary in order to protect an employer's legitimate business interests. The majority of states, including Idaho, Kansas, New York, Ohio, Pennsylvania, South Dakota and Texas, utilize this approach. Employers should take note, however, that even courts in reasonable modification states may refuse to rewrite overbroad non-compete agreements if it appears that the employer unreasonably overreached.

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• ***Blue-Pencil Doctrine:*** The courts of Colorado, Minnesota, and North Carolina, among several others, follow the "blue-pencil" rule. Under this approach, courts may simply strike from the agreement the provisions that are overbroad and enforce everything else. Generally, any restraint beyond what is necessary to protect the employer's legitimate interests will be deemed unreasonable and will be stricken, provided the remainder of the agreement meets the reasonable standard. If the agreement cannot survive the striking of the overbroad clause, then the entire agreement may be unenforceable. One way for the company to combat this may be to utilize alternative restraints (e.g., establish and articulate geographic scopes by radius, by city, and by county). Thus, employers can make it possible for the court to strike overbroad clauses and still enforce the remaining provisions.

• ***No-Modification:*** Still other states including Louisiana, Nebraska, Oklahoma and Wyoming follow a strict "no-modification" approach. This is essentially an all-or-nothing rule of enforceability. Under this approach a court may not rewrite overbroad provisions, nor may it strike offending provisions and enforce the remainder of an agreement as is the case under the blue-pencil rule. Rather, a court employing the no-modification approach will strictly scrutinize the agreement, and if it is unreasonable as written, the court will not enforce it at all.

Companies should be cautious about including overly broad restrictions in non-compete agreements, as it may allow employees to avoid enforcement.

Enforcing restrictive covenant agreements

An employee who signed a non-compete agreement leaves the company to work for a competitor or solicits customers in violation of the agreement. Now what?

The employer must take reasonable and timely steps to protect its interests. A first step may be to send the employee and his/her new employer a letter notifying them of the employee's contractual obligations and demanding compliance. If harm may occur before compliance can be demanded, or it is clear that the employee and/or new employer will not honor the employee's restrictive covenants, the company may have to seek issuance of a temporary restraining order and/or temporary injunction. To obtain injunctive relief, the company will have to comply with local procedural requirements, which in most jurisdictions means moving quickly to demonstrate that irreparable (non-monetary) harm will likely occur if the employee is not enjoined. In most jurisdictions, if a restraining order is issued, a contested evidentiary hearing must be held within weeks thereafter to determine if the employee will be enjoined while the parties' contractual and other obligations are fully litigated.

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In contested cases, the employee (and likely the new employer) will often attempt to break the non-compete agreement by arguing that the agreement is either not supported by proper consideration or is too broad in light of the company's protectable interests.

In some cases, employees of energy companies have successfully defeated enforcement of non-compete agreements by arguing that the "confidential" information they received through employment as consideration for their non-compete was not actually confidential or proprietary information sufficient to support the non-compete. For example, most energy service companies consider the identities of their customers and the type of work being done for them to be confidential, but that same information may be known generally within the industry, known to other vendors who service the customer, or ascertainable from public sources (like the Internet). In some cases, customer contact information has been found not to be confidential where it was published in industry directories or publicly known. In other cases, employees have successfully argued that customer contact information was not confidential because the company allowed employees to link to customers on their personal LinkedIn or Facebook accounts. Companies should consider how they allow employees to interact and share data with and about customers.

In some cases, employees of energy service companies have been able to successfully fight enforcement of non-compete agreements by arguing that the geographic scope or prohibited activities in the non-compete agreement were too broad in light of the employee's specific role with the employer. As an example, an executive responsible for an energy service company's Latin American sales might avoid enforcement of a non-compete which would be broad enough to preclude working for a competitor handling Gulf of Mexico sales. Likewise, an agreement which would prevent an energy services company sales, finance or HR executive from working

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for an E&P company may not be enforceable.

In many non-compete cases, the employee and/or new employer successfully fight enforcement by arguing that the company failed to take reasonable steps to protect its confidential and proprietary information and/or failed to uniformly enforce non-compete agreements against other similarly situated employees. In these cases, the employee may convince a judge that the company is not exposed to imminent, irreparable harm. The steps taken (or not taken) by the company to protect itself may impact on the enforceability of a non-compete agreement. Simply requiring employees to sign non-compete agreements may not be enough.

Best practices

As competition for talent gets more intense, and as companies seek to better protect their human and technical assets, non-compete agreements are becoming more and more common in the energy sector. Companies that wish to use non-compete and non-solicitation agreements should do so with care, which means using agreements drafted narrowly to comply with applicable laws and taking steps to enforce those agreements and protect company assets.

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