

Non-compete Agreements with Employees

This Practice Note from our website provides an overview of non-compete agreements between employers and employees. This Note contains general information that is not jurisdiction-specific. For information on state law requirements, see the State Q&A Tools on practicallaw.com.

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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 specified period of time. Employers use non-competes to protect their valuable corporate assets, such as trade secrets and goodwill.

This Practice Note provides a broad overview of non-compete agreements. In particular, it considers:

- The benefits and limitations of non-competes.
- Key issues to assess when drafting a non-compete.
- Plans and procedures when seeking to enforce a non-compete.
- Available legal protection as an alternative to, or in the absence of, a non-compete.

BENEFITS TO EMPLOYERS

Non-compete agreements benefit employers by providing them with 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 competitors.

Non-competes are particularly useful to employers in cases where an employee has important confidential information or trade secrets. Although most employees have some important company knowledge, 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 enter into effective and enforceable non-competes with them.

LIMITATIONS ON ENFORCEABILITY

Not all non-compete agreements are enforceable. Enforceability is a question of state law and may vary among states and

industries. Courts in most states recognize that non-competes 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. In other states, however, post-employment non-compete agreements are generally void unless they fall under a narrow statutory exception.

JURISDICTION-SPECIFIC LIMITATIONS

In certain jurisdictions, non-compete agreements are entirely or largely unenforceable, regardless of the impact that competition may have on an employer's business. For example, in California, employee non-compete agreements restricting post-employment conduct are unenforceable. However, non-competes are enforceable in California when they arise in the context of the sale or dissolution of a business. California employers can also still use other means to protect trade secrets and other information, for example, by using confidentiality and non-disclosure agreements (see below *Alternatives to Non-compete Agreements*).

>> For more information on using non-competes in California in the context of an acquisition, search [M&A in California](#) on our website or see page 36 in this issue.

INDUSTRY-SPECIFIC LIMITATIONS

Non-compete agreements may not be appropriate or enforceable in all industries. For example, non-competes are generally not enforceable against attorneys because of ethical prohibitions on preventing clients from retaining the attorney of their choice. There are limited exceptions. For instance, Ohio authorizes narrow restrictions on the practice of law for retiring attorneys.

Many states also 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 physician with access to certain patient lists and medical records.
- Allow for a buy-out of the non-compete at a reasonable price.

Colorado similarly restricts the enforceability of non-competes in the medical profession.

In states where there is no statutory framework for non-competes, courts have refused to enforce physician non-competes where doing so would harm the public. This is not true in all states. Illinois courts, for instance, do not analyze physician non-competes differently from those involving other professions and industries (other than the legal profession).

>> For more information on industry-specific limitations on the enforceability of non-compete agreements in various states, search [Non-compete Laws: State Q&A Tool](#) on our website.

DRAFTING A NON-COMPETE AGREEMENT

To be enforceable, a non-compete agreement must satisfy the requirements of contract law and state law specific to non-competes.

CONTRACT LAW REQUIREMENTS

Non-compete agreements must be supported by adequate consideration. This 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.
- The non-compete is signed during the employment relationship, rather than before the employee begins working for the employer.

Offer of At-will Employment as Consideration

At-will employment can be terminated by the employer or employee at any time, for any lawful reason. In most jurisdictions, the offer of at-will employment will alone be adequate consideration for a non-compete if the non-compete was entered into at the beginning of the employment relationship.

However, in some jurisdictions, an offer of at-will employment is not sufficient consideration. For example, in Texas, 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 other words, 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 those interests. 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 being protected by the non-compete.

Continuing Employment as Consideration

Even in jurisdictions where at-will employment constitutes adequate consideration, courts may not enforce a non-compete agreement if the parties entered into it after the employment relationship began. This is because continuing at-will employment as sole consideration may not be sufficient. Once an employee has commenced employment, many courts require that the employer provide the employee with an additional benefit to make the non-compete enforceable.

Traditional Contract Law Challenges

Non-compete agreements may also be vulnerable to challenges applicable to all contracts. For example, a party may challenge a non-compete on grounds of duress, unconscionability, lack of capacity and coercion.

STATE LAW SPECIFIC TO NON-COMPETE AGREEMENTS

All states in which non-compete agreements are enforceable require that the restrictions placed on an employee be reasonable in duration and scope. Further, 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, have articulated the principle that 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. Although there are very few bright line rules, the general guidelines set out below are applicable in most states.

Reasonableness of Duration

The reasonableness of a non-compete agreement's duration is generally determined by evaluating the unique facts of each case. If the employer is concerned about confidential information possessed by a former employee, courts will look at the volatility and longevity of that information. For example, an executive in possession of the company's long-term strategic plans could reasonably be restricted from competing for a significant period of time. However, if the confidential information is valuable for only a short period of time, then the duration of the non-compete restriction should match that period.

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, but a restraint that exceeds two years is presumptively unreasonable. However, it is not unusual to find cases in other jurisdictions enforcing non-competes for longer periods of two or even three years for sales employees or middle management. Courts become more critical once the duration exceeds three years.

Reasonableness of Geographic Scope

The reasonableness of a non-compete agreement's geographic scope is generally determined by the employer's business

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.

However, many states have greater restrictions. For example, in Texas, the geographic scope is determined by the employee's activities, not those of the employer. Typically, an employee who was responsible for a specific geographic region cannot be restricted from competing in other regions in which 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 be appropriate for certain types of employees and businesses. Through the use of electronic means of communication, employees may have the ability to work and perform services on a nationwide basis without ever leaving one city. Therefore, a restriction limited 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 non-compete agreement with a one-year restraint period and geographic scope that included all of the US because it involved online transactions that were not geographically confined (see *National Business Services, Inc. v. Wright*, 2 F. Supp. 2d 701 (E.D. Penn. 1998)).

Dynamic or Changing Restrictions

If a non-compete agreement's geographic or other restrictions depend on circumstances that may change after execution, the non-compete can be attacked on the grounds that its terms are too indefinite to be enforced. For example, employers may attempt to describe the restrictions in dynamic terms, including by prohibiting an employee from:

- Competing in the region for which he is responsible at the time of termination.
- Soliciting customers with whom he worked at the time of termination.

In some states, these variable contract terms may be unenforceable on their face.

Relevance of Termination of Employment

In some states, courts will consider an employee's involuntary termination when evaluating the enforceability of a non-compete agreement. For example, a few courts have held that the employer's need to protect its trade secrets or confidential information is no longer worthy of protection given that the employer, apparently, no longer values the employee. This is the minority approach, however, and the termination of an employee without cause will not invalidate a non-compete in

most jurisdictions unless the employer has itself engaged in a violation of the law.

REFORMATION OF OVERBROAD NON-COMPETE AGREEMENTS

Most states permit courts to modify a non-compete agreement that is overbroad but otherwise enforceable to ensure that its restrictions are reasonable. A few states, however, do not permit modification, or "blue-penciling," of non-competes in the employment context. For example, modification is not permitted in Nebraska (see *Whitten v. Malcolm*, 541 N.W.2d 45 (Neb. 1995)).

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

Even when a non-compete 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 courts to reform otherwise enforceable non-competes that contain unreasonable duration or scope restrictions. However, if a non-compete is overbroad, the employer cannot recover damages for breaches of the non-compete that occurred before the reformation. (See *Tex. Bus. & Comm. Code* § 15.51(c).)

DRAFTING CONSIDERATIONS

Non-compete agreements should be drafted to address the particular circumstances of the employment relationship. There are many provisions that are appropriate for some employees and not for others. Using form non-competes without customization for all employees, regardless of position, job responsibilities, knowledge and access to confidential information can be detrimental. This is because using a form is some evidence that the non-compete was not drafted to ensure it is only as restrictive as necessary to protect the employer's interest.

In addition to the contract law and state law requirements discussed above, employers should assess their individual circumstances, existing contract terms and the law of their jurisdiction when determining whether particular provisions are appropriate for their needs and enforceable. Provisions that employers should consider when drafting non-competes include, among others:

- **Tolling provisions.** Employers may include a provision that tolls (suspends) or extends the restrictive period during any time that the employee is in violation of his obligations or during litigation of the issue. Otherwise, a court may refuse to toll the restrictive period (see *EMC Corp. v. Arturi*, 655 F.3d 75 (1st Cir. 2011)) (applying Massachusetts law in affirming the trial court's refusal to grant a preliminary injunction to toll a former employee's

non-compete and non-solicitation period where the agreement did not include a tolling provision)).

- **Prohibitions on competition and preparation for competition during employment.** State law generally allows employees to prepare to compete if this 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 may establish their right to obtain monetary remedies and equitable remedies. Some jurisdictions may also allow for contracts imposing liquidated damages.
- **Notification provisions.** Employers may require a departing employee to disclose the identity of his new employer and nature of the new position. This creates an obligation that ordinarily does not otherwise exist and may assist in enforcement of a non-compete. Employers may also require the employee to provide a copy of the valid and enforceable non-compete to any future employer.
- **Garden leave clauses.** Employers may include 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 non-compete, depending on state law. Employers should carefully draft and structure any garden leave provision to avoid adverse tax consequences under Section 409A of the Internal Revenue Code.

>> For a Practice Note providing more information on Internal Revenue Code Section 409A, search [Section 409A: Deferred Compensation Tax Rules: Overview](#) on our website.

- **Mandatory arbitration clauses.** Employers may add an arbitration clause to the non-compete. When using arbitration clauses, the employer should consider whether it wants any request for preliminary or emergency relief to be handled by an arbitrator or a court.
- **Choice of law clauses.** Employers may identify a specific state’s law that will govern interpretation of the non-compete. A choice of law provision improves the likelihood that the parties’ expectations about governing law will be met. However, these provisions are frequently subject to litigation.
- **Venue and forum selection clauses.** Employers may include a venue (geographic location) and forum (court or other tribunal) selection clause. These provisions provide greater certainty about where litigation will occur and can enhance the likelihood that the parties’ choice of law provision will be enforced.
- **Blue-pencil clauses.** If authorized by state law, employers may add a blue-pencil clause allowing a court interpreting the non-compete to strike out or modify unenforceable portions of the non-compete.

ENFORCING A NON-COMPETE AGREEMENT

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

HANDLING DEPARTING EMPLOYEES

Employers should ensure that departing employees are aware of their 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 may also take the following actions:

- **Provide applicable agreements.** The employer should consider providing the departing 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.
- **Remind the employee of obligations to return company property.** The employer may want to remind the employee of any general obligations under state common law to return all company property, including intellectual property and confidential information, and not to divulge any of this information in the future.
- **Learn about the employee’s future plans.** Employers can 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.
- **Reach out to business contacts.** Employers should consider notifying customers, vendors and other important business contacts of 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 the employer is to lose business. An employer can also advise customers of the former employee’s contractual obligations. However, there is some risk that if the non-compete is unenforceable, the employer could face tort liability for interfering with the employee’s legitimate business relationship.

EVALUATING 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 the situation. This analysis should

be undertaken 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 address the following questions:

- 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 a customer, or is the harm speculative?
- If the employer has been harmed, can the damages be quantified or is the harm difficult to calculate 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 is the forum? 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?

PURSUING LEGAL ACTION

Once the employer has evaluated its chances of success in enforcement of the non-compete agreement (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 may choose to either send a cease and desist letter or similar communication or proceed immediately to litigation. Each approach is appropriate in some circumstances, but not in 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 agreement before it results in litigation. Cease and desist letters:

- Remind employees of their contractual and legal obligations.
- Inform employees that their former employer believes that they have breached these 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 will almost always know more than it did before sending the letter.

- **Possibly avoiding litigation.** If the employer is hesitant to start litigation, it is worthwhile to contact the former employee and try to resolve the dispute.
- **Extending the timeline for legal action.** The letter buys the employer time to react 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 to inform the new employer that its new employee is bound by a non-compete and explain how the employment of the former employee may unlawfully interfere with the non-compete. However, if the employee is terminated by his new employer because of this letter, but the non-compete is invalid, the employee may have a claim for tortious interference with contract, or in some jurisdictions, a claim for termination in violation of public policy (see *Silguero v. Creteguard*, 187 Cal.App.4th 60 (2010)).

Litigation

An employer may forego sending a cease and desist letter in favor of immediate litigation. This approach may be preferable if:

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

Typically, the goal in filing suit to enforce a non-compete agreement is 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 non-compete or otherwise preserves the circumstances as they existed before the violation of the non-compete.

The standard for obtaining an injunction differs among states 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 suffered or will suffer irreparable harm (harm that cannot be remedied through the payment of money).
- The balance of the harm faced by the employer compared with the harm the former employee could suffer through issuing an injunction favors an injunction.
- The public interest is not adversely affected by the issuance of an 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 difficulty meeting the standard. Employers may seek the following types of injunctive relief:

- **Temporary restraining order (TRO).** A TRO is an order that is generally 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. They are typically designed to last for the period up until the parties go to trial. As a result, although preliminary injunctions have a specific duration, they can 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 be subject to the ruling for much of the term of the non-compete at issue.

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 in 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 injunction 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.

ALTERNATIVES TO NON-COMPETE AGREEMENTS

RELATED AGREEMENTS

Non-compete agreements 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:

- **Agreements not to solicit clients.** Legal scrutiny of agreements not to solicit clients, in most but not all jurisdictions, are conducted similarly to legal evaluations of non-competes. Some states, such as California, view customer non-solicitation agreements as anti-competitive and allow these provisions in only narrow circumstances.
- **Agreements not to hire employees or recruit employees.** These agreements are typically not subject to the same rigorous standards as non-competes and are enforceable based on ordinary contract law. In California, employee non-solicitation provisions are only enforceable in certain circumstances.

- **Confidentiality agreements.** These agreements do not contain non-compete provisions, but they do define the scope of protected information and prohibit its use or disclosure.
- **Assignments 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.

INEVITABLE DISCLOSURE DOCTRINE

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 their former employer's trade secrets. Most often, the inevitable disclosure doctrine arises after an employee who is not bound by a non-compete agreement 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 inevitable disclosure doctrine is not recognized in all states. For example, although New York has recognized it, California has rejected the doctrine (see *Whyte v. Schlage Lock Co.*, 101 Cal.App.4th 1443 (2002)). Even where recognized, the doctrine requires a higher degree of proof to obtain the same relief available under 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 his old job.
- The value of the trade secrets to both the new employer and the previous employer.

>> For information on state law requirements for non-compete agreements, search [Non-compete Laws: State Q&A Tool](#) on our website.

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