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Assessing Noncompetition Agreements and Minimizing Risk in the Hiring Process

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Covenants not to compete have become an increasingly popular tool among employers who wish to accomplish any of a variety of objectives: to protect trade secrets, to prevent the solicitation of customers, to discourage employees from seeking employment elsewhere, and to discourage competitors from hiring their employees. The legal treatment of noncompetition agreements varies widely from state to state and even from court to court. And misperceptions among employees and some lawyers about the enforceability of such agreements abound.

Companies who unwittingly hire employees with noncompetition agreements, or who misjudge their enforceability or the zeal with which the former employer is likely to seek to protect its interests, can find themselves the subject of a lawsuit alleging tortious interference. Such litigation is more than expensive, it can be particularly disruptive and invasive to the employer's business interests. One central area of inquiry involves the employee's day to day activities, which sometimes implicates customers or other third parties whom the hiring company will not want hassled by subpoenas or exposed to allegations of misconduct by the new employer and employee. Another fundamental problem arises from the fact that the party seeking discovery is typically a competitor, to whom information about items such as competitive activities, revenue and profit margins, and hiring practices are not ordinarily (or happily) disclosed. While protective orders are commonly used, they do not provide much comfort to the producing party.

A careful approach in the hiring process, particularly in industries which rely heavily on such agreements, can serve to protect the new employer, the new employee, and in sales or professional services industries, customers who can be caught in the crossfire. While no amount of preparation can prevent litigation by a former employer who wishes to disrupt competition, whether or not its reasons are legitimate, there are pitfalls that can be avoided, and precautionary steps that can decrease the likelihood of litigation and better position a company to defend itself (and its new employee) if litigation ensues.

It should be part of a company's standard script to ask its prospective employees if they have any type of employment agreement or other contractual relationships that could affect their acceptance of a position or their activities once hired. Many prospective employees do not know the answer to this question; covenants not to compete are often buried in generic employment agreements, employee handbooks, or even bonus or stock option awards, and for obvious reasons the applicant can be reluctant to begin asking her employer questions about the contents of her personnel file. The prospective employer takes a risk by hiring the employee without further information about restrictions that may exist. Upon learning that an agreement exists, the prospective employer should request a copy and have it reviewed by legal counsel. Particularly in cases involving high-level or sophisticated employees, the prospective employee should be encouraged to hire separate counsel to do the same.

Reviewing the agreement

The first step in assessing a covenant not to compete is determining the applicable law. Many multistate employers have choice of law (and sometimes choice of forum) clauses in their form agreements. However, these clauses are not always enforceable. Where the agreement is silent, many states (and most litigants) appear to assume that the agreement will be governed by the law of the state in which the employee has worked; others assess where the contract was formed or what state has the most significant relationship to the agreement. Where an employee has lived and/or worked in multiple states, the choice of law analysis can be particularly complicated.

Once the applicable law is determined, it is helpful to get an overview of the state's general attitude towards covenants not to compete. In some states they are fairly easy to enforce, but it can be nearly impossible in others. Understanding the underlying public policy determinations can inform the remainder of the analysis,

the hiring decision, and any litigation that follows. Common underpinnings include fundamental public policy issues such as restraints of trade, "right to work", and protection of trade secrets.

The degree of specificity among state law varies widely as well. Some states rely on common law, with a rule that can usually be boiled down to something like this: a covenant not to compete is enforceable if reasonable under the circumstances. Other states have statutes, some of which are extremely detailed, establishing the requirements for enforceability based on a variety of factors and under a variety of circumstances. Not all of the statutes are easy to interpret, and others have given rise to complex judicial wrangling.

Assuming a covenant is generally enforceable, its scope merits careful scrutiny as well. Elements to consider include: the duration of the restriction, geographic scope of the restriction, the nature of the restricted activities, and a consideration of how all of the restrictions relate to the interest the noncompete seeks to protect. Careful attention should be paid to whether the covenant prohibits the employee from engaging in any competition whatsoever, or whether its restrictions are limited to the solicitation of customers and prospective customers of the former employer. Some states differentiate between the two agreements as "noncompetition agreements" and "nonsolicitation agreements." However, these definitions are not universally used, and a reference to a "noncompetition agreement" often refers to any type of restraint on competition, including the solicitation of customers, while a "nonsolicitation agreement" can also refer to the common additional provision prohibiting an employee from soliciting former co-workers on behalf of the new employer.

Local practice can be the single most important factor in assessing the risk associated with a covenant not to compete.

The difficulty in analyzing the scope of a noncompetition agreement is that there are few bright line tests to determine whether a covenant will or will not be enforceable. A few jurisdictions have statutory limitations or presumptions that are quite helpful to a hiring company in determining the risk associated with the hiring of the candidate. But in most jurisdictions the analysis is so fact-intensive that predicting how a particular judge will view the agreement in light of facts and positions that do not all even exist at the time of the assessment is akin to a simple toss of the dice.

Assessing the impact of local law and practice

It is also helpful to determine the effect of a finding that the scope of a noncompetition agreement is overbroad. Some jurisdictions will invalidate a noncompete that is overbroad or unreasonable in scope. Others give the trial court discretion to modify the terms so that the scope is appropriate. Others require the trial court to do so. And some permit the trial court to strike offending provisions, but not to modify them. Such reformation is often referred to as a "blue pencil" doctrine.

In fact, local practice can be the single most important factor in assessing the risk associated with a covenant not to compete. Relatively few noncompete cases go to trial, and even fewer end up on appeal. Most enforcement actions involve a request for a temporary restraining order and/or temporary or preliminary injunction. In determining whether to grant this relief, the trial court must make an early assessment of the enforceability and scope of the covenant. Whether the injunction is granted or denied, the vast majority of cases tend to resolve through settlement. First, by the time the case is reached for trial on the merits, the bulk of the period of restraint, if not more, may have passed. If the employee is to be restrained for that period of time, the initial victory by the former employer may constitute a de facto victory on the merits. Likewise, if the employee is not restrained, winning a permanent injunction at trial for the remainder of the time period may be of relatively insignificant benefit. And if the restraint is denied due to the trial court's concern over enforceability, the former employer's interest in pursuing either a permanent injunction or damages is necessarily dampered.

Knowing in advance the proclivities of the local judges can be invaluable: the author has encountered jurisdictions where it is said that local judges will never restrain more than the active solicitation of recent clients, no matter what state law provides. Other judges or groups of judges may be inclined to rubber-stamp any request for temporary relief that comes their way. In this area more than most other commercial or employment matters, local counsel with true experience with these disputes can be a critical asset.

Other prudent precautions

Due diligence can also include an investigation of the former employer's history with respect to noncompetition agreements. This includes whether the company tends to consistently enforce its agreements - inconsistency can be a powerful defense in many jurisdictions, because it evidences that the alleged "protectable interests" may not be as vital to the company in practice as asserted in court. It also includes whether the former employer has been consistent in its judicial positions. Where the former employer has been involved in litigation over its own hiring of employees, it may have taken legal or factual positions in its defense that are inconsistent with its efforts to enforce its own agreements.

Consistency is a two-way street. If the hiring company intends to assert that the former employer's noncompetition agreement is unenforceable, it should consider whether it intends to ask the new employee to sign its own noncompete and whether its form of agreement may suffer

from the same alleged deficiencies. It makes for a powerful argument that the new employer actively uses the provisions in issue, and the new employer will find its defense of the present case used against it the next time it seeks to enforce its own noncompete against a departing employee.

A careful assessment (and insulation) of a potential new hire should also involve efforts to avoid ancillary claims. Litigation over noncompetition agreements often includes a related claim that the employee committed a pre-termination breach of duty and/or misappropriated or misused the former employer's confidential information or trade secrets after departure. Where there is arguable merit to the factual allegations, it is frequently the result of the employee's failure to understand his legal obligations and the fact that the former employer may be scrutinizing his recent activities, which can sometimes appear suspicious even when done in the ordinary course of business with proper intentions.

Some employees believe that their work product is similar to a school term paper, that they are entitled to take or copy it for nostalgia's sake, or use as a reference for future projects. In some situations, this is perfectly true; in others, it can constitute conversion, theft, misappropriation of trade secrets, and breach of a nondisclosure agreement. Other employees cannot resist the urge to speak with customers about their plans to resign, seeking the comfort of knowing that the customers will "follow them" to a new opportunity. These situations can sometimes be avoided through clear, detailed direction by the hiring company.

It can be helpful to specifically instruct candidates for employment that they should not discuss their job-hunting process with co-workers or customers, and that they should not use or reveal confidential information belonging to their former employers either during the interview process or after they join the company. The downside to this approach occurs when an employee violates these instructions, often without bad intention, and the new employer must decide whether to terminate the interviews/job offer/employment or risk having the violation used as evidence of wrongdoing in litigation. The upside, of course, is that the instructions may prevent unfortunate actions from occurring in the first place, and that the new employer can defend itself against a subsequent claim by pointing to its instructions as evidence of its good faith.

At the time an offer of employment is made, it can also be beneficial to provide specific instructions concerning the employee's resignation and departure from the previous employer. Among other things, the employee should be told to take great care in the removal (including by email or downloading) of any information or even personal possessions from the office prior to resignation. These activities can suggest misconduct, even where none is present. Ideally, the employee will be instructed at the time of resignation as to whether and how the employee will be permitted to pack personal belongings. Sometimes the employer does this itself, others allow the employee to do so, with or without a witness. Even if allowed to pack alone, it can be helpful to have someone with authority "bless" the items being removed to avoid later speculation about what was taken.

The employee should also be told to diligently search his or her home and car for any business related information that originated with the former employer. This includes information on a personal email account and home computer or personal laptop, cell phone or PDA, as well as home offices and other places where the employee may have worked. The employer may be consulted about whether this information should be discarded or returned; with electronic information, the most reasonable way to "return" the information is to copy the information to a portable storage device such as a thumb drive and certify to the employer that the information has been deleted from the source. Others will accept the employee's assurance of deletion, comforted in part by the thoughtful and professional approach taken by the employee.

These types of instructions serve several purposes. They can help avoid inadvertent misconduct or misunderstandings. They also send a message to the former employer that the departing employee is taking care to comply with his duties. And in the event of litigation, they evidence an overt good faith effort to protect the former employer's interests and to "play fair."

Conclusion

Implementation of these guidelines can require a "reorientation" of a company's employees who are actively recruiting new employees, often without regard to (or interest in) legal formalities. But a careful approach to the hiring process can help to minimize the chance of any litigation at all, and the assertion of meritorious claims in particular.

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Endnotes

1. *See, e.g.*, La. Rev. Stat. Ann . § 23:921(A)(2); *Hostetler v. Answerthink, Inc.*, 599 S.E.2d 271, 274-75 (Ga. Ct. App. 2004); *DeSantis v. Wackenhut*, 793 S.W.2d 670 (Tex. 1990).

2. *Cent. Adjustment Bureau, Inc. v. Ingram*, 678 S.W.2d 28, 32-33 (Tenn. 1984).

3. Tex. Bus. & Com. Code § 15.50; Okla. Stat. tit. 15, § 219A.

4. Fla. Stat. Ann . § 542.335; Cal. Bus. & Prof. Code § 16600.

5. *See, e.g.*, *Light v. Centel Cellular Co.*, 883 S.W.2d 642 (Tex. 1994); Alex Sheshunoff Mgmt. Servs., Inc. v. Johnson, 209 S.W.3d 644 (Tex. 2006).

6. *Palmer & Cay, Inc. v. Marsh & McLennan Cos.*, 404 F.3d 1297, 1306 (11th Cir. 2005).

7. *Sevier Ins. Agency, Inc. v. Willis Corroon Corp. of Birmingham*, 711 So. 2d 995, 998 (Ala. 1998), *overruled on other grounds by Ex parte* Howell Eng'g & Surveying, Inc., 2006 WL 3692536 (Ala. Dec. 15, 2006) (not yet released for publication).

8. Fla. Stat. Ann . § 542.335; Okla. Stat. tit. 15, § 219A.

9. *White v. Fletcher/Mayo/Assocs., Inc.*, 303 S.E.2d 746, 748 (Ga. 1983); Lanmark Tech., Inc. v. Canales, 454 F. Supp. 2d 524, 529 (E.D. Va. 2006).

10. *Valley Med. Specialists v. Farber*, 982 P.2d 1277, 1286 (Ariz. 1999).

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