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Drafting And Enforcing Noncompetes: What Employers Need To Know

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Do you know what to do when your top salesperson is leaving to join forces with your top competitor? Or maybe it is your principal engineer or a high level executive. All that time, training and money. Your investment in that employee is lost. Worse, by joining a competitor the employee now threatens to cause irreparable harm by disclosing your trade secrets or luring away your customers. What can you do?

If you have to ask, it may be too late. Protecting company assets takes planning, vigilance and enforcement. One of the first questions to ask is whether the departing employee has a "noncompete" or other specific contractual obligations to your company. Common examples include non-competition, non-solicitation of customers, non-solicitation of employees (anti-raiding) and non-disclosure agreements. This article provides employers with guidance for drafting and enforcing non-competition and other post-employment restrictive covenants.

Get With The Program

A noncompete alone will *not* protect an employer's trade secrets or customer accounts. Many employers mistakenly assume that if a noncompete is a valid contract, then courts will enforce it. In fact, courts will not enforce an otherwise valid noncompete unless it is necessary to protect assets that the employer itself has made a substantial investment in developing and protecting. As a result, noncompetes are effective only when integrated with a comprehensive asset protection program. Contractual safeguards, such as noncompetes and nondisclosure agreements, can be an important part of that program. However, they must be combined with physical and electronic security measures that limit access to and disclosure of proprietary information. Locked drawers, guarded facilities, password protected networks, use of confidential labels, all of these precautions will help build a persuasive case that your company's confidential information warrants judicial protection. The program should also include written policies that are easy to understand and well publicized. Every employee needs to know his or her responsibilities when it comes to protecting company assets. On the flip side, they also need to know the consequences for failing to fulfill those responsibilities. Periodic training, constant monitoring and consistent enforcement will determine the effectiveness of your asset protection program.

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Better Late Than Never

What can you do if that departing salesperson, executive or engineer never signed a noncompete or other post-employment agreement? Ideally, employees should sign noncompetes at the start of their employment. But if that opportunity has passed, there are alternatives. Over half the states will permit noncompetes to be signed later in a career, as a condition of continued employment. But even in those states it is advisable to link the noncompete to some additional consideration provided to the employee, such as stock options, a promotion or other significant changes in duties, responsibilities or compensation. If the employee has given notice or it is otherwise too late to impose a noncompete as a condition of continued employment, consider negotiating a "back end" noncompete. Asking employees to sign noncompetes at the back end of their employment can be effective when combined with a substantial severance payment, stock plan, health plan or other benefit continuing after the employment relationship ends. In those situations, courts often find an acceptable balance: the employee voluntary accepts certain restrictions on future employment but receives in exchange sufficient benefits to offset the impact of the employment restrictions. Late action can still be effective action.

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Even if you do not obtain a written noncompete agreement, or the noncompete in place turns out to be unenforceable, your company still has rights. You can seek court protection based on statutory or common laws that prohibit misappropriation of trade secrets, breach of loyalty, tortious interference or unfair competition, to name just a few. Accordingly, your noncompetes and employment agreements should make clear that they do not supersede the company's other rights and remedies under state and federal laws.

One Size Won't Fit All

Resist the temptation to apply form noncompetes to all employees. Like round pegs in square holes, one noncompete will not fit all employees. In fact, the more tailored the restrictions, the more likely a court will enforce them. In drafting noncompetes, ask yourself: what harm can this particular employee, or class of employees, *realistically* cause my company if they went to work for a competitor? Do you really need to keep an employee from working for *any* competitor? In *any* position? In *any* territory? Courts look for reasonable restrictions in time and scope. If confidential financial data becomes obsolete after two quarters, then a multi-year restriction may appear unreasonable. Similarly, if a salesperson only solicits customers in Massachusetts, then a nationwide restriction looks unduly harsh. Match restrictions to the realistic threats posed by a class of employees.

Employers must also match post-employment restrictions to the laws of the states in which their employees work. State laws vary widely. While Florida, New Jersey and Massachusetts courts will uphold reasonably tailored noncompetes in a variety of circumstances, other states can be much less generous. California, for example, generally prohibits the enforcement of noncompetes outside the sale of a business. Texas normally will not enforce noncompetes against at-will employees unless the noncompete is ancillary to another valid contract, and Oklahoma will only prohibit direct customer solicitations and only for one year. Accordingly, noncompetes need to be tailored to both the employee and the jurisdiction. Consider a choice of law provision that applies the most favorable state law and reserving the right to make unilateral changes to the scope of the restrictions to ensure enforcement.

Not Created Equal

Choose only the post-employment restrictions the company really needs to protect its assets because not all restrictions are created equal. Non-competition restrictions are the toughest to enforce. They draw strict scrutiny from courts because they are "restraints on trade" which keep people out of work. Other types of restrictions can be just as effective without drawing the strict scrutiny of a "restraint on trade." Non-solicitation, non-disclosure, forfeiture and anti-piracy provisions are usually easier to enforce because they restrict employment options, not prohibit them entirely. Consider whether your company will be protected if the departing employee is prohibited only from soliciting his former customer accounts. Or if trade secrets are more at issue, will a non-disclosure and stock option forfeiture agreement adequately protect your interests? Whichever restrictions you choose, make sure they are independent and "severable" so that one bad apple will not spoil the bunch. Some courts will strike or "blue pencil" overly broad restrictions and enforce the rest, but other courts will only enforce the agreement as written. If it's too broad, then that's too bad. Choose wisely.

Snooze, You Lose

If a departing employee threatens irreparable harm to your company's competitive position, then you must act quickly. Once trade secrets have been revealed, the damage has been done. Once a customer switches sides, a court will not order them back. Send out cease and desist letters at the first sign of possible violation, and be prepared to run to court for temporary restraining orders or preliminary injunctions. Sometimes even the most vigilant employers may not uncover a noncompete violation until the term of the noncompete is nearly over. Consider adding to your noncompetes provisions extending the term of the employment restrictions for the period in which the employee is violating them, and tolling the expiration of the restrictions upon the filing of any lawsuit in which the noncompete is challenged. An employer that sits on its rights may lose them.

Wash Your Hands

Enforcing noncompetes is a matter of equity, and when you come to court seeking equitable relief you want to have "clean hands." In other words, you want to be the good guy, having acted responsibly and now deserving of aid. Pleas for help may fall on deaf ears, however, if your company has not done much to help itself by, for example, taking appropriate security measures or narrowly tailoring the restrictions it seeks to enforce. Similarly, employers will have a more difficult time enforcing noncompetes if they do so late, inconsistently or after breaching employee agreements or terminating employees involuntarily. Consider adding to your noncompetes specific statements about the legitimate purpose of the employment restrictions. Ask employees to acknowledge that the restrictions are necessary to protect the company's assets, reasonable in scope, and unlikely to interfere with the employee's ability to earn a living or pursue a chosen career.

Follow Your Nose

If you suspect a former employee may be competing unfairly, do not wait for the evidence to come to you. Investigate. Follow the trail. Use a forensic team to track the employee's email, check his computer hard drive and review other electronic records. Interview his colleagues; talk with trustworthy customers. You may find that smoking gun.

Do Not Be Shy

Noncompetes should not be hidden or down played. They must be heard, internally and externally, to be effective. Employees must be aware of their post-employment obligations while they are still employed. When employees are leaving, post-employment obligations should be discussed during exit interviews and brought to the attention of new employers. Consider including in your noncompetes provisions requiring departing employees to notify you of their new employment and to notify new employers of their legal obligations to your company. Prompt communication will often result in prompt resolutions.

Bring It On!

Noncompetes prohibit only *unfair* competition. Employers should make it clear that they welcome a fair fight. Do not overreach or appear vindictive, seeking to prevent the former employee from finding any employment anywhere. Rather, identify the legitimate business interests you need to protect, choose carefully what post-employment restrictions you need to protect those interests, and then enforce those restrictions promptly and consistently. Companies should not have to subsidize their competitors with misappropriated trade secrets or customer relationships. In that context, noncompetes are a laudable, effective means of promoting sound business practices and preventing unfair competition.