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Are Employment Non-Compete Agreements Enforceable?

By Gary Trachten

In this article, the author discusses whether employment non-compete agreements are enforceable.

Are employment non-compete agreements enforceable? The short answer is, it depends. It is complicated. And the law of non-competes is far from uniform from state to state.

In some jurisdictions, i.e., California, Oklahoma, North Dakota, and Washington, D.C., most (if not all) forms of non-compete agreements are unlawful and unenforceable.

About a dozen states have statutes that restrict or condition the use of non-compete agreements, and the trend in state legislatures is to pass more limitations on their use.

Even where non-competes are enforceable, courts consistently recite that they are "disfavored in the law" because they create impediments to peoples' abilities to earn a living in their chosen field and make markets less free. Thus, courts police non-compete agreements and often find them to violate public policy and therefore unenforceable. Some months ago, President Biden issued the Promoting Competition in the American Economy Order that asks the Federal Trade Commission to "curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility."

Nonetheless, companies have legitimate interests in protecting bona fide confidential information. For the most part, for information to be bona fide confidential its secrecy must give a company a competitive advantage in the marketplace. However, companies often try to stretch that notion of confidential information by contractually defining it to extend

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to everything that is said or done within their four walls. Companies also generally have legitimate interests in the customer goodwill that they engender through their employees. However, they often try to stretch that notion by contractually depriving former employees of their right to use the goodwill they had brought with them when first hired.

FOUR TYPES OF POST-EMPLOYMENT NON-COMPETES

There are essentially four types of post-employment non-compete covenants. They are:

- An employee promises not to perform services for any competitor for a specified duration – sometimes limited to a geographical territory. These range from extremely broad (may not work in any capacity for any unit of any competitor) to more specific (agrees not to work for a competitor in a capacity like the one they worked in for the former employer) restrictions.

- A promise not to solicit clients and customers of the former employer to become clients or customers of the employee's new employer (or anyone else).

- A promise, for a specified period, not to solicit employees of the former employer to terminate their employment, generally to join the employee's new employer.

- A promise to forever hold confidential information that is descriptively defined in the agreement – which if described too broadly can (as explained below) be a backdoor way of obtaining a perpetual non-compete. Courts sometimes scrutinize these to make sure they are not enforceable as backdoor unreasonable non-competes. On other occasions, courts enforce them, as they would any contract, in accordance with their stated terms.

Post-employment non-compete contracts must strike a balance between the legitimate interests of an employer to protect against unfair competition, and interests of employees in their mobility, and the public at large in robustly free and fair markets. The public interest extends to labor markets because the markets for goods and services are most efficient when there is competition for talent. Employers, who usually have the greater bargaining power, naturally desire to limit competition as much as they can. While employees prefer not to have their future job opportunities restricted, they often so much want the offered job that they often reluctantly sign on to non-competes, often mistakenly believing the common refrain that they are anyway unenforceable. Neither the customers nor the public are at the bargaining table to assert their interests.

WHAT IS REASONABLE?

Despite legislative trends, non-competes are for the most part enforceable if they are "reasonable," with "reasonable" in this context being a term of art. An agreement is "reasonable" if:

(1) Necessary (or in some states useful) to protect legitimate employer interests;

(2) No broader in scope than is required to protect those legitimate interests;

(3) Not unduly burdensome for the employee; and

(4) Not meaningfully detrimental to the public interest.

In New York, an employer bears the burden of demonstrating that the agreement meets all four prongs of this test. However, in some other states the former employee contesting the enforceability of a non-compete covenant bears the burden of proving that the covenant he or she signed is not reasonable.

Since there is a public policy interest in robust competition, "legitimate" interests exclude an employer's interest in reducing fair competition. For the most part, legitimate interests extend only to (a) protecting confidential information that the former employee had access to that can be used in an unfair manner against the former employer, or (b) protecting against the former employee unfairly competing by exploiting the customer goodwill that the former employer had engendered through the employee. The trend in the law is that restraints on soliciting or hiring the former employer's employees are not enforceable because these employer legitimate interests are not served by such restraints. But some courts nonetheless enforce "non-poach" restrictions on grounds that they do not interfere with the ability of the person who signed the agreement to obtain employment.

In determining whether the scope of the written restraint is greater than is enforceable, courts scrutinize its duration, nature, and geographic reach. An enforceable duration should be no longer than the useful shelf-life of confidential information to which the employee had access, or the period within which a replacement employee would have sufficient opportunity to cultivate similar goodwill. While court may find a covenant not to work for a competitor too broad to be enforceable, it may in the same case enforce a restraint on soliciting those customers who had been serviced by the former employee. The geographic scope may not extend beyond the employer's current and soon-to-be markets.

Whether a restriction imposes an "undue burden" on the employee calls for a subjective judgment. Is the employee's experience and skills readily transferable to another employer for similar compensation? A court might consider how well the employee had been compensated during the employment. In a few industries, the customary agreement provides for the employer to pay the employee non-compete pay during the period of restriction, and this will go far in establishing that the restriction does not impose an undue burden.

The public interest concerns whether the agreement unduly limits fair competition for talent between companies and/or is detrimental to the interests of clients, patients, or customers in being able to decide who they want to service them.

Confidentiality covenants are generally perpetual and when they reasonably define confidential information they will be enforced so long as the information remains confidential. But when they are overbroad in their description of what is confidential, such as when generic business strategies are defined to be a "secret sauce," that can be detrimental to the former employee's ability to work in the field. Courts often (but not always) recognize that where the purpose and/or effect of a confidentiality agreement is unjustifiably anti-competitive, it is a backdoor, perpetual, and unenforceable non-compete agreement.

Depending on the law on the particular state, court that finds a non-compete to be unenforceable overbroad in scope may nonetheless choose to re-write the scope and enforce it, or "bule pencil" the agreement by striking (rather than re-writing) the overbroad terms, or void the agreement in toto if a narrower version would have passed muster.

"YOU'RE FIRED, AND DON'T FORGET YOUR NON-COMPETE!"

As a rule, when a non-compete is part of a broader or simultaneous employment contract, the non-compete will not be enforceable when the employer materially breaches the employment agreement such as by firing the employee without cause during the agreed-to term. But what about when an employer fires without cause an "at-will" employee (who has no contract that protects from being thus fired) but had signed a non-compete agreement?

Can the employer enforce the agreement? That very much depends on the state law that applies. Although the non-compete will still be enforceable in most states, the current governing case law in New York is that an employer that fires an employee without cause loses its right to enforce the non-compete. But what in this context constitutes "cause" is far from clear. Nor is it clear whether the language of the agreement ("termination for any reason") can trump the rule.

SELF-ENFORCING

Whether and the extent to which a non-compete is enforceable (where enforceable at all) in a court depends little on the language of the agreement but a great deal on the circumstances.

But this is the most important thing to know: Regardless of what a court would decide, non-competes are most often self-enforcing. That is because most employers, even if they recognize that the applicant's non-compete is not likely enforceable, will usually decline to hire someone who signed a non-compete because they want to avoid the risk and expense of potential litigation.

That risk is not limited to becoming embroiled in litigation against (and seeking to enjoin) the employee, but also litigation against the new employer. If the new employer procures an employee's breach of a valid non-complete, the new employer could be liable to the former employer for interference with the non-compete agreement.