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# WCP EMPLOYMENT LAW NEWSLETTER

## Noncompete Agreements

Noncompete agreements[1] are becoming increasingly important as the competition for talent and expertise intensifies. This is true not only in the high-tech marketplace, but more and more it also is true in the "old economy" marketplace where employers find themselves spending more to recruit, train, and retain highly skilled employees. In this competitive climate, many employers see noncompete agreements as essential to protecting their investments in key employees and, in some cases, their market edge. Employees also are increasingly sophisticated in negotiating noncompete agreements (often assisted by counsel) and trying to circumvent them when advantageous to do so.

Just as the marketplace is changing quickly, so, too, is the law changing rapidly in this area. One thing is clear: in today's extraordinarily fluid labor market, a basic understanding of noncompete agreements and the principles of their enforceability is essential for employers whose business interests would be harmed if key employees were free to leave and begin competing with them. This newsletter highlights some of the major issues in this area.

**General Enforceability Considerations**. The principal means of enforcing noncompete agreements is by obtaining injunctive relief from a court forbidding a former employee to engage in specific conduct for a period of time. Courts do not automatically enforce noncompete agreements that restrict an individual's freedom to work—even if the individual freely entered into the agreement and his conduct unquestionably violates it. Courts ordinarily enforce such agreements only if they find that the agreements are reasonable in scope and duration, are necessary to protect the employer's legitimate business interests, and do not unnecessarily restrict the individual's ability to earn a living. Judicial reluctance to enforce noncompete agreements automatically reflects concern that such agreements in some cases may be contrary to the public policy favoring full employment. Indeed, some states have enacted statutes limiting the enforcement of noncompete agreements under certain circumstances because of this same public policy concern. California

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[1] We use the term "noncompete agreements" to refer to agreements between an employer and an employee that restrict the employee's right to engage in particular types of business activities while employed by the employer or after the termination of employment. Noncompete agreements are often entered into simultaneously with agreements that limit the right to solicit customers or employees (nonsolicitation agreements) and/or agreements that restrict the use of confidential or proprietary information (confidentiality agreements).

law, for example, provides that noncompete agreements barring an individual from a business, trade, or profession generally are not enforceable (except in the case of the sale of a business, or similar transaction, or dissolution of a partnership or limited liability company), although the California courts have recognized various circumstances in which they will give effect to otherwise prohibited noncompete agreements (such as where a bargained-for contractual provision bars a party only from courting a particular customer, as opposed to a significant portion of an industry, or where the provision bars a party from engaging in only a small or limited part of a business).

**Reasonableness of Restrictions**. Before a court will enjoin a violation of a noncompete agreement, it must determine that the restrictions are "reasonable," under the specific circumstances, in terms of (1) the particular limitations on the individual's activities, (2) the length of time the restrictions apply, and (3) the geographic scope in which the restrictions are intended to operate. The narrower the restrictions on prohibited activities, the more likely it is that a court will find them reasonable and enforceable. Thus, for example, it is more likely that a restriction against selling a particular product will be upheld than a bar against working in any capacity in an entire industry. On the other hand, the restrictions need to be broad enough to protect the employer's legitimate interests by preventing the range of activities that would reasonably be expected to cause economic harm.

Likewise, the shorter the intended duration of the restrictions, the more likely they are to be enforced. Until recently, courts routinely enforced noncompetes of up to one year (and occasionally even longer) in most businesses and industries. However, there seems to be a trend toward looking harder at one-year restrictions in particular businesses and industries where rapidly changing markets render technical or proprietary knowledge obsolete more quickly, and a year may be longer than necessary to protect the interests of the employer. In one recent case, for example, the court refused to enforce a one-year noncompete in the Internet publishing business because, given the "dynamic nature" of the industry, a "one-year hiatus from the workforce is several generations, if not an eternity."[2] Just how strong this trend is, and which industries will be affected by it, remains to be seen.

Geographic scope also is very much a question of where the particular business actually competes and where the departing employee has contacts (customers, suppliers, coworkers) that could be exploited to the detriment of the employer's legitimate business interests. In the past, when many businesses competed for employees and customers in essentially local or regional markets, geographic scope was ordinarily analyzed in terms of miles. However, in today's increasingly Internet-dominated environment, many high-tech and Internet-related businesses are worldwide in scope, not local or regional. This may be one area where the courts will actually consider *expanding* traditional notions of the territory within which a noncompete might be reasonable.

**Protection of the Employer's Legitimate Economic Interests**. In most jurisdictions, even if the court considers the noncompete restrictions reasonable on their face, it still will not enforce them against a former employee unless it is persuaded that the restrictions are necessary to protect the legitimate economic interests of the employer. On occasion, the courts have partially enforced noncompetes—enjoining only those aspects of the prohibited conduct that actually threaten to harm the employer's economic interests. For example, it is not uncommon for a court simply to enjoin a former salesman from soliciting former customers for the purpose of making sales for the new employer, even though the noncompete prohibited employment of any kind with a

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[2] *EarthWeb, Inc. v. Schlack*, 71 F. Supp. 2d 299, 313 (S.D.N.Y. 1999), *remanded on other grounds*, 205 F. 3d 1322 (2d Cir. 2000).

competitor. The key is that courts do not enforce noncompetes in order to punish employees who breach them, but only to protect the legitimate economic interests of the former employers.

**Recruitment and Hiring of Employees Subject to Existing Noncompete Agreements.** Employers frequently face questions about how to treat prospective employees who may be subject to noncompete agreements. There are no easy answers to these questions. It is generally the case in most jurisdictions that an employer who actively recruits and hires away from his existing employer an employee bound by a noncompete agreement may be liable for intentional interference with a contractual relationship or any of a number of similar common law torts, particularly when the recruiting employer has knowledge that there was an existing contractual relationship and takes steps to encourage or induce the employee to breach the contract.

The specific facts of each situation are critical in evaluating the risks to the prospective employer of exploring and offering employment to the prospective employee. Pertinent facts often include the history of the contacts that resulted in the offer of employment, the degree of competition between the companies, the specific restrictions in the noncompete, and the overlap (if any) between the individual's prior and prospective positions.

Because noncompete agreements for certain types of employees and in certain types of industries are increasingly common, many employers now make it a practice to ask prospective employees at an early stage in the recruiting process whether they are parties to any type of noncompete agreements. When there are such agreements in place, careful analysis of their impact on the prospective hire and on the prospective employer should be an important part of the hiring decision. If the decision is made to extend an offer of employment, it may also be appropriate to consider whether to impose restrictions, and what kind of restrictions to impose, on the employee after he begins work to minimize the risk of litigation by the former employer against the employee and the new employer.

## Additional Considerations.

- The selection of a choice of law provision to govern an employment or noncompete agreement can be critical in determining whether, and the extent to which, it will be enforced. In general, courts will respect the parties' choice of law so long as it was a reasonable choice and the state whose law is selected to govern the contract has a significant relationship to the covered conduct. California ordinarily is not the best choice of law for an employer if there are other available choices.

- Most noncompete agreements entered into between the seller/employee and the buyer/employer of a business are ordinarily enforced by the courts because it is presumed that the sale of the business includes the sale of its goodwill and that economic harm will come to the buyer if the seller/employee breaches his commitment not to compete with the business he sold.

- Employers who try to enforce noncompete agreements against former employees are often at a disadvantage in demonstrating that enforcement is essential to protect their economic interests if they have not entered into similar noncompetes with similarly situated employees and/or if they have not sought to enforce them under similar circumstances. Thus, consistency in obtaining and enforcing noncompete agreements can be important.

- Finally, even if an employer has not entered into a valid noncompete agreement with an employee, it may still be able to obtain some form of injunctive relief against an employee or former employee who engages, or threatens to engage, in unfair trade practices, theft of trade secrets, or other forms of unfair competition.

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We at Wilmer, Cutler & Pickering have considerable experience in advising clients about the negotiation and interpretation of noncompete agreements, as well as litigating noncompete disputes. If we can assist you in any way, please contact **Carolyn Cox** (202-663-6645), **Roger Yoerges** (202-663-6122), or **Allison Goodman Gold** (202-663-6927).

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