Holland & Hart

The Disappearing Future of Non-Compete Agreements

Tyson Horrocks

Partner
801.799.5923
Salt Lake City, Las Vegas
TCHorrocks@hollandhart.com

S. Jordan Walsh

Of Counsel
775.327.3040
Reno
sjwalsh@hollandhart.com

Shaun Kennedy

Partner
303.295.8377
Denver, Washington, DC
sckennedy@hollandhart.com

Insight — November 10, 2021

ERE Recruiting Intelligence

Republished with permission ERE Media, Inc. Originally appeared in the November 10, 2021 online edition of ERE.net

For the last two decades, with the principal exception of California and a handful of other jurisdictions, non-competition covenants have been a standard component of the defense architecture for U.S. companies to protect valuable confidential information and trade secrets from falling into the hands of a competitor. Over time, though, this tool has been dramatically curtailed.

Hostility to non-competition agreements is growing. In July, President Biden deputized the Federal Trade Commission (FTC) to explore nationwide restrictions on their use. Additionally, in the last five years, state-law restrictions on entering into non-competition agreements with low-wage earners have been adopted in Illinois, Maine, Maryland, New Hampshire, New York, Rhode Island, Virginia, and Washington (and the District of Columbia will see new restrictions take effect in April 2022).

With this changing landscape, it appears less and less likely that courts will enjoin employees from working for competitors altogether except in limited circumstances. Combined with the relative ease through which confidential information and trade secrets can flow electronically, this should cause alarm bells to ring in the halls of corporate America — companies would be wise to put in place robust measures to protect the outbound flow of sensitive trade secret information before it occurs so that employees simply cannot take high value data to a competitor.

A Changing Landscape

On July 9, President Joe Biden had signed an executive order that calls upon the FTC to address the alleged abuse of non-competition agreements. While the order itself lacks teeth and does not itself ban non-compete agreements, it demonstrates a continued push by leadership in Washington to create employee-friendly laws and regulations.

In announcing the order, the Biden Administration asserts that 1 in 3 businesses currently require workers to sign a non-compete agreement and 1 in 5 workers without a college education is currently subject to a non-compete. According to the administration, roughly 50% of private-sector businesses require at least some employees to enter non-compete agreements, affecting between 36 and 60 million workers.

Brit Merrill

Associate
801.799.5865
Salt Lake City
BJMerrill@hollandhart.com

Despite the widespread use of non-competition agreements, there is no uniformity among states (or even employers) regarding the value of non-compete agreements. Traditionally, the regulation and enforcement of non-competition agreements has been handled by the individual states. However, should the issues raised in the executive order gain traction, this power could be taken from the states and handled by legislators and/or agencies based in Washington.

In the meantime, employers should take particular caution to ensure that their non-compete agreements sufficiently articulate the reasoning behind the covenant, including without limitation access to trade secret, confidential and/or proprietary information. Employers should also reinforce, and in some cases strengthen, their “confidentiality” agreements with employees — should non-compete provisions become unenforceable, employers will need to rely on such provisions to protect the improper use of their information by former employees.

California's Long-Standing Restrictions

Most employers know that they can't enforce non-compete agreements in California. But the state doesn't simply prohibit the use of non-compete agreements; it outright voids any contract that “restrains” an employee from “engaging in a lawful profession, trade, or business of any kind.”

In other words, the state's limitations on restrictive covenants reach well past non-compete agreements, rendering any agreement that tries to prevent an employee from seeking lawful future employment void. This also includes post-employment agreements that forbid solicitation of customers and employees.

Additionally, there is a sale-of-business exception in California that applies to situations where an owner, member, or partner in a business sells their interest and/or goodwill to another, or otherwise dissolves the business. When this occurs, and the purchaser operates a similar business in the geographic area where the owner, member, or partner once operated, the seller may be required not to compete with the purchaser's business in that geographic area for a particular time period.

Outside of this exception, employers may not use post-employment non-compete agreements and/or post-employment non-solicitation agreements to prevent their employees from moving to a competitor.

Often, though, we see employers try to circumvent these restrictions by adding a choice of law or venue provision in their employment agreements or employee handbooks. However, employers may not, as a condition of employment, require employees who live and work in California to agree to resolve employment disputes outside of California or using another state's laws. The only exception to this rule applies when an employee is individually *and actually* represented by legal counsel and able to negotiate the terms of their employment contract. Therefore, generally, a foreign choice-of-law/venue provision will be void in most situations.

Additionally, a word of warning to employers who wish to use broad (and

unenforceable) restrictive covenants and choice-of-law provisions in their California-based employment agreements: This heavy-handed approach can backfire.

First, these kinds of restrictive covenants not only render the terms of the illegal restrictive covenant void; they also undermine the validity of the entire contract and may act to void the entire agreement. Also, employers (including individual agents, managers, or officers) may not require any employee or applicant to agree, in writing, to any terms that are known by the employer to be unlawful.

Further, using prohibited restrictive covenants is considered an act of unfair competition. As such, employers that engage in this conduct may be subject to civil liability for unfair competition, including significant civil penalties, as well as economic damages to employees resulting from such conduct..

Restrictions Cropping Up Nationwide

Most states permit non-competes in some form or another, imposing limits on the period of restriction, restricting the geographic scope, or, increasingly, setting bans on non-competes for low-wage earners.

A handful of states, including Utah and Massachusetts, have enacted statutes that restrict temporal limitations to one year. Other states, including Florida, Georgia, and Washington, identify durations that are presumptively reasonable ranging from six months to two years.

In other states, temporal reasonableness is generally determined by evaluating the unique facts of each case. Several states have imposed limitations on geographic location, limiting the scope to the location of the employee's activities or the specific geographic areas for which the employee was responsible.

Finally, in a growing number of states, including Illinois, Maine, Maryland, New Hampshire, New York, Rhode Island, Virginia, and Washington, employers are prohibited from entering into non-compete clauses with low-wage workers.

The District of Columbia Ban

The District of Columbia recently joined the parade by passing one of the most restrictive non-compete laws in the country. It not only bans non-compete provisions in employment agreements and policies but also bans any policy or agreement that would prohibit D.C. employees from simultaneously working for other employers.

The stated purpose of the law is to make void and unenforceable non-compete provisions entered into after its first applicable date (currently Apr. 1, 2022.) The D.C. Council is still debating some proposed exceptions to the ban that were not included in the legislation as adopted, including an exception to the simultaneous work ban for “a bona fide conflict of interest.”

Whether the proposed amendments become law remains to be seen. However, employers can take some solace in the fact that the law will not have retroactive impact to non-competes entered into before April 1, 2022.

Best Practices in an Evolving Environment

Businesses should proactively monitor changes in each jurisdiction in which they operate. Meanwhile, as technology develops to make transmission of data easier and easier, companies need to get ahead of the risks of data disclosure to a competitor by taking proactive measures to restrict the outbound flow of sensitive business data. This may include any of the following steps:

1. Create policies and procedures that clearly define the scope of the company's proprietary information and/or trade secrets. Reference such policies and procedures in employment contracts, offers of employment, and employee handbooks.
2. Develop and consistently use contractual agreements that restrict an employee from disclosing or improperly utilizing proprietary information and/or trade secrets. Such agreements include non-disclosure agreements, invention assignment agreements, and pre-existing intellectual property disclosures. Ensure these agreements are reviewed on a periodic basis for on-going legal compliance.
3. Remind employees of their ongoing duty to preserve, and not to disclose, company proprietary information and/or trade secrets on an intermittent basis. This may take the form of periodic employee training modules or requiring employees to acknowledge a log-in notification message when accessing information systems containing sensitive company information.
4. Limit information-system access to authorized company users. Create and enforce access-control protocols (i.e., network, file, and individual document access levels) that safeguard company proprietary information and/or trade secrets.
5. Implement data-security policies and procedures that further describe employees' roles and responsibilities, coordination among organizational entities, and allow for regular compliance monitoring.
6. Eliminate all information-system access when no longer required.
7. Consider data encryption and other technical measures to protect data when transmitted electronically.
8. Implement a robust out-boarding process with departing employees that emphasizes an ongoing duty to protect, and to not disclose, company proprietary information and/or trade secrets.
9. Establish procedures for employees to return all company-owned property prior to departure.

While the above list is not intended to be exhaustive, these precautions can help businesses protect critical property in the absence of robust non-compete enforcement.

Given that non-competes are, to some extent, a means of prohibiting disclosure after-the-fact, companies would be wise to take proactive

measures to restrict the outbound flow of competition-sensitive data before any breach occurs.
