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Recent Developments in Non-Compete Law

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Employers have long used restrictive covenant agreements to protect sensitive information about their business and their clients, as well as their investment in training their employees and in developing and maintaining client and vendor relationships. Recent development of more comprehensive data on the number of workers working under restrictive covenants, as well as research into the impact of restrictive covenants on economic growth, have led a number of state legislatures and government agencies to turn their eyes toward restrictive covenant enforcement and potential reform. In 2015 and 2016, a number of state legislatures introduced or passed legislation specifically aimed at narrowing the scope of interests that will legally support judicial enforcement of restrictive covenants and/or limiting the enforceability of non-compete agreements – a specific subset of restrictive covenants that prevent an employee from working for or as a competitor of their previous employer.

In this month's column, we survey the recent non-compete legislation and examine several specific government investigations into non-compete practices. We further outline a number of suggestions for employers to consider when reviewing their use of non-compete agreements.

Background

Employers have used restrictive covenants (which encompass non-competes as well as non-solicitation and non-disclosure covenants) as a management tool since before the Industrial Revolution, when European artisans operated under the classical guild system of apprentices, journeymen, and master craftsmen.¹ Employers' reasons for using such agreements have not changed much since then. Employers rely on restrictive covenants to protect their investments in developing and cultivating human resources, customer relationships, and confidential business information. Scrutiny of such agreements by governmental actors also has not changed much since that time, as courts and legislatures typically view restrictive covenants as restraints on free trade and on an individual's right to practice their chosen profession.

State law generally governs the enforceability of restrictive covenants, often through a mix of state statutes and common law. Chapter 8 of the recently updated Restatement on Employment Law reflects an attempt to create common principles of enforcement notwithstanding these individual state variations, and time will tell how widely courts and/or state legislators adopt these guidelines.² For now, though, this variation in state law standards has led to a continuum of "friendliness" towards restrictive covenants in different

jurisdictions. On one end of the spectrum states such as California³ and Oklahoma⁴ have enacted statutes that void all non-competition agreements unless they fit into very specific exceptions. On the other end of the spectrum, state law specifies that Florida courts must presume reasonable in time any restrictive covenant of five years or less predicated on the protection of trade secrets, and prohibits courts from considering any individualized hardship that might be caused to the employee in evaluating a covenant's reasonableness.⁵

Blue Pencil

Most states fall somewhere in the middle of those two extremes, and will enforce restrictive covenants only if reasonable in scope and necessary to protect a legitimate business interest of the employer. One of the prime differentiators of these "middle of the road" states concerns whether courts may "blue pencil" an overbroad restrictive covenant. In some states, if a court determines that any portion of the restrictive covenant is overbroad, the court will decline to enforce the entire covenant.⁶ In other states, however, courts may "blue pencil" an overbroad restrictive covenant by altering its terms to make the covenant enforceable.⁷ Even among "blue pencil" states there is some variation, as courts in some states *may* alter a covenant to make it reasonable, while courts in other states are *required* to do so.⁸

Focus on Lower-Level Employees

In recent years, critics of restrictive covenants have focused on companies that require all employees to sign non-compete agreements, regardless of the level of the employees' positions. The main arguments against such broad application are that (1) the traditional justifications provided for enforcement of non-competes do not apply to low level employees, and (2) lower level employees often lack the sophistication to understand the implications of signing non-competes and/or do not have the bargaining power to resist an employer's blanket requirement to sign one.

The U.S. Treasury Office of Economic Policy⁹ and the White House¹⁰ highlighted these critiques in

two reports released in March 2016 and May 2016, respectively. Based on recent studies, and the survey data backing said studies, the reports assert that despite being unlikely to be privy to trade secrets that would allow them to compete unfairly with their current employer should they choose to resign, 15 percent of workers without a four-year college degree are subject to non-competes, and 14 percent of workers earning less than \$40,000 are subject to non-competes. According to the government reports, if these employees are not privy to competitively sensitive information, one of the foremost justifications provided for non-compete enforcement does not apply to them.

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New York Attorney General Eric Schneiderman has vocally criticized requiring lower-level employees to sign non-compete agreements. In 2016, Schneiderman conducted three high-profile investigations into the non-compete policies and practices of major companies, and all resulted in concessions from the targeted companies. Law360 (a legal publishing company), Jimmy John's (a gourmet sandwich chain), and Examination Management Services, Inc. (a nationwide medical information services provider) all agreed to limit their use of non-compete agreements with respect to lower-level employees.¹¹ In addition, Schneiderman announced that he planned to introduce legislation in 2017 that would prohibit the use of non-competes for low-wage employees and require employers to pay employees additional consideration if they sign non-compete agreements.¹²

Legislative Developments

New York is not the only state in which non-competes have recently become a governmental focus. In the

last two years, six states have passed legislation that reduced the enforceability of non-compete agreements – Alabama, Hawaii, Illinois, New Mexico, Oregon, and Utah. Alabama’s Restrictive Covenants Act specifically delineates the protectable interests that can provide the backbone of a valid restrictive covenant.¹³ Hawaii’s state legislature amended the state statute governing employee restrictive covenants to void any non-compete or non-solicitation clauses in any employment contract relating to an employee of a “technology business.”¹⁴

The Illinois Freedom to Work Act expressly prohibits employers from entering into non-competes with any employee earning the greater of the applicable federal, state or local minimum wage or \$13.00 per hour.¹⁵ New Mexico’s state legislature enacted a bill

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that makes a non-compete provision that restricts the right of a health care practitioner to provide clinical health care services unenforceable upon termination of the practitioner’s employment.¹⁶ Oregon’s state legislature enacted a bill which limits enforceability of non-compete agreements to 18 months from the date of the employee’s termination, down from two years in the previous version of the statute.¹⁷ Finally, Utah’s state legislature enacted the Post-Employment Restrictions Act, which limits the enforceability of non-compete agreements to one year from the date of the employee’s termination, and makes an employer liable for an employee’s arbitration costs, attorney fees, and actual damages if the employer seeks to enforce a non-compete provision and it is determined that the non-compete is unenforceable.¹⁸

Legislators in another seven states have introduced or proposed legislation in the last two years that would limit enforcement of restrictive covenants, including in Idaho,

Maryland, Massachusetts, Michigan, Missouri, New Jersey, and Washington. In addition to these efforts on the state level, Senators Al Franken (D-MN) and Chris Murphy (D-CT) proposed federal legislation in 2015 that would prohibit employers from requiring low-wage employees to enter into covenants not to compete, and would require employers to notify potential employees of any requirement to enter into a covenant not to compete at the beginning of the hiring process.¹⁹

Practice Tips

In order to deal with the shifting legal landscape, employers should review the applicable state law governing enforcement of restrictive covenants in each state in which the employer operates. While potentially time-consuming for employers that operate across many different states, the degree of variability in enforcement and the above-described wave of recent legislation creates the possibility that a uniform non-compete applicable to all employees might be overbroad in some states and/or too narrow in other states.

Employers should further consider differentiating between employees in the same state by identifying the specific information or protectable interest that they would seek to protect with respect to employees in different positions. For example, an information technology company may be focused on protection of its IP and trade secrets with respect to its engineers, while focusing on protecting sensitive personnel information with respect to its Human Resources employees. Employers may also consider implementing non-competes of different durations for different employees based on the information to which they are privy. Companies may even wish to articulate in an employee’s agreement the specific information it is seeking to protect via a non-compete. This increased level of granularity would allow a company to better ascertain whether in fact they need non-compete agreements at all for certain groups of employees, and the duration of any agreement they would need to protect the applicable information.

Employers also may wish to review whether they can adequately protect their interests through the use of non-solicitation and non-disclosure agreements

rather than a non-compete agreement. Most of the above-described amendments to state statutes serve to limit enforceability of *non-compete* covenants, but have a comparatively smaller impact on the enforceability of other kinds of restrictive covenants. In many jurisdictions, courts will examine customer and employee non-solicitation clauses under a more lenient standard of review, because such clauses do not raise the same concerns regarding limitations on an employee's right to make a living. Accordingly, in certain circumstances, employers may be able to achieve the same objectives by using a non-solicitation covenant as they would with a non-compete without the same degree of enforcement concerns. Note, however, that these types of restrictive covenants also may be subject to statutory and common law restrictions on enforceability.

1. Dan Messeloff, *Giving the Green Light to Silicon Alley Employees: No-Compete Agreements between Internet Companies and Employees under New York Law*, 11 Fordham Intell. Prop. Media & Ent. L.J. 711 (2001) at 715-717.
2. <https://www.ali.org/publications/show/employment-law/>.
3. Cal. Bus. & Prof. Code § 16600.
4. 15 Okl.St. Ann. § 217.
5. F. S. A. § 542.335.
6. See, e.g., *Advance Tech. Consultants, Inc. v. Roadtrac, LLC*, 250 Ga. App. 317, 320, 551 S.E.2d 735, 737 (2001).
7. See, e.g., *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 394, 712 N.E.2d 1220, 1226 (1999).
8. Compare *BDO Seidman v. Hirshberg* with Tex. Bus. & Com. Code Ann. § 15.51(c).
9. <https://www.treasury.gov/resource-center/economic-policy/Documents/UST%20Non-competes%20Report.pdf>.
10. <https://obamawhitehouse.archives.gov/blog/2016/05/05/what-you-need-know-about-non-compete-agreements-and-how-states-are-responding>.
11. <https://ag.ny.gov/press-release/ag-schneiderman-agreement-ends-non-compete-agreements-employees-national-medical>.
12. <https://ag.ny.gov/press-release/ag-schneiderman-proposes-nations-most-comprehensive-bill-curb-widespread-misuse-non>.

13. <https://legiscan.com/AL/text/HB352/id/1244857/Alabama-2015-HB352-Enrolled.pdf>.
14. http://www.capitol.hawaii.gov/session2015/bills/HB1090_CD1_.HTM.
15. <http://www.ilga.gov/legislation/publicacts/fulltext.asp?Name=099-0860>.
16. <https://www.nmlegis.gov/Sessions/15%20Regular/final/SB0325.pdf>.
17. <https://olis.leg.state.or.us/liz/2015R1/Downloads/MeasureDocument/HB3236>.
18. <http://le.utah.gov/~2016/bills/static/hb0251.html>.
19. <http://www.franken.senate.gov/files/documents/150604MOVEsummary.pdf>.

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