**Drafting Non-Competes: Five Things To Do Before You Pick Up The Pen And Five Things To Think About After You Do**

**Elizabeth Bohannon, Williams Sonoma**
**Frank Buckley, Allegis Group, Inc./TEKsystems, Inc.**
**Karen Lane, CVS Caremark**
**Jackie Lichty, Littler Mendelson**

1. **Introduction and Welcome.**

2. **Five Things *To Do*Before Drafting Starts.**

    a. **Number One**: Audit and Identify Protectable Interests.

        i. What business interests are you seeking to protect? Talk to your client. If you are in an enforcement scenario, what will be your corporate representative testimony on these issues?

            1. Goodwill?
                a. Do employees have access to customers?
                b. What is the typical customer relationship from a temporal standpoint?
                c. How long to replace goodwill with a customer?
                    i. Jurisdictions vary as to the length of the temporal limitation that can be justified by the protection of goodwill. For example, in Arizona, the reasonable duration of a restrictive covenant, the purpose of which is to protect customer relationships, is only the time necessary to put a new employee on the job and for the new employee to have a "'reasonable opportunity to demonstrate his effectiveness'" to the customer. *Amex Distrib. Co. v. Mascari*, 724 P.2d 596, 603 (Ariz. Ct. App. 1986) (quoting Blake, Employment Agreements Not to Compete, 73 Harv. L. Rev. 625, 677 (1960)).

            2. Confidential Information and trade secrets? Protection of trade secrets and confidential information is perhaps the most commonly used and most widely accepted protectable interest used to justify noncompetes in the employment context.
                a. What kind of information do employees have access to?
                    i. Inevitable disclosure arguments
                b. What is the "shelf life" of the information?
                c. Guard against the argument that nondisclosure provisions are sufficient to protect these interests.

i. Consider stipulation regarding inadequacy of nondisclosure provision, standing alone.

d. Does the confidentiality and nondisclosure provision need to address specific items of confidential information?

e. Does your client already have a confidentiality policy in place? What does the code of conduct say? "Sync up" the new Agreement with what may be out there already.

3. Special training? Some jurisdictions, like Florida, recognize unique training that would provide value to a competitor is a legitimate interest to be protected by a noncompete. *See, e.g.*,FLA. STAT. ANN. §542.335(1)(b)(5) (listing extraordinary or specialized training as a protectable interest).
   a. Do employees receive training, what kind?
   b. How long to train a new employee and get up to speed?
   c. Liquidated damages, training reimbursement provisions?

4. Sale of business?Noncompetes entered into in the context of the sale of a business are usually more readily enforced than those entered into in the context of an ordinary employment relationship. *See Dicen v. New Sesco, Inc.*, 839 N.E.2d 684, 687 (Ind. 2005); *Dawson v. Temps Plus, Inc*., 987 S.W.2d 722, 726 (Ark. 1999) (noncompete covenants in employment contracts "are subject to stricter scrutiny than those connected with the sale of a business"); *Kim's Hair Studio LLC v. Rogers*, No. 05-CBAR-1245 (Conn. Super. Ct. July 20, 2005) (sale of business noncompetes are "more readily enforceable" than employment noncompetes); *Gannv. Morris*, 122 Ariz. 517, 596 P.2d 43, 44–45 (Ct. App. 1979).

5. Unique talent or promotional investment? Note: many jurisdictions have statutes regarding noncompetes with broadcast talent.

6. Workforce stability? It is important to check applicable law regarding the ability to use workforce stability as the legitimate interest upon which to base a noncompete. For example, under Missouri statute, an employer has an express covenant-protectable interest in the stability of its workforce. 28 MO. STAT. ANN. §431.202. Yet, in Washington, this may not be the case. *See Labriola v. Pollard*, 152 Wash. 2d 828, 100 P.3d 791 (Wash. 2004) (holding unenforceable a restraint "designed to stabilize a company's current workforce").

ii. What is the harm created by an employee going to work for a competitor?
   1. What will your operations/sales people say regarding the nature of the harm?How is that harm inevitable?

2. Determine the levels of employees/positions who will be signing.
    a. Are different agreements in order? One size fits all may not be appropriate.
    b. Some states, such as Oregon and Colorado, have statutes limiting noncompetes to employees in certain positions.
    c. Consider pyramid approach:
        i. At the highest level (justifying the broadest provisions) would be high level executives.
            1. Larger/deeper level of confidential information
            2. More potential for harm
        ii. Regional Managers/High Level Sales
            1. Restrictions narrowed based on job responsibilities/territories
        iii. Mid-Level Employees
            1. Protections for confidential information and customers
        iv. Rank and File
            1. Nondisclosure
3. Is a true geographically-based noncompete necessary or is a customer-based restriction enough?

b. **Number Two**: <u>Anticipate Enforcement Scenarios-What is the End Game?</u>

i. Deterrence?
    1. Implicates forfeiture, clawback, and/or liquidated damages provisions
    2. Attorneys' fees provisions
ii. Conciliation?
    1. Flexible agreement that encourages employees to discuss their plans upon departure to potentially obtain "carve out" from true noncompete.
    2. Implicates notice requirements, early resolution process.
iii. What has your client's enforcement history been? What impact on enforcement actions in the future?
    1. Formal mandatory mediation/arbitration?
    2. Mandatory venue?

c. **Number Three**: <u>Consider Format, Tone, and Administration</u>.

i. Ferrari (all the bells and whistles) vs. Cadillac (luxury, but not high-maintenance) vs. Honda (solid and dependable, good "gas mileage")
ii. Talk to the people who will be implementing the agreements: what level of administrative support will you have from them in ensuring agreements consistently signed timely and appropriately?

1. Consider whether multiple stand-alone versions are better to accommodate state variations? Or use an appendix approach? Or go for 90% chance of enforceability and reduce the number of variations, etc.

iii. Consider the corporate culture regarding non-competes.
   1. Morale
      a. Any ability to use deferred compensation to help encourage execution?
   2. Recruiting
   3. Retention
      a. Protective measures to address possible raiding by competitors who use a roll-out to current employees as a "pinch point" to recruit

iv. How will the agreements be executed?
   1. E-signature or traditional signature?
      a. Plan for "proving up" e-sig process, possibly involve IT.

v. If an agreement is already in place, prepare new template or simply a revised version of existing agreement?
   1. Ability to use old agreement as a "road map" to identify strategic changes.

d. **Number Four**: <u>Plan: For Consideration and Roll-Out</u>.

i. Are agreements going to be signed by new hires only or incumbent employees?
   1. In Idaho, restrictions greater than 18 months require consideration in addition to employment itself.

ii. If for new hires, consider including requirement of noncompete in offer letter.
   1. Oregon requires this.
   2. Forestalls "reliance" and "estoppel" type claims.

iii. Consideration-any issues for current employees?
   1. If new consideration is needed, what to give?
      a. Oregon requires "bona fide advancement."
      b. Most jurisdictions will not delve into adequacy of consideration, but in some states the sufficiency of consideration has been successfully challenged. *See, e.g.*, *Corp. Health Strategies v. Smith*, 11 Conn. L. Trib. No. 6 at 15 (Super. Ct. Aug. 17, 1984) (finding continued employment plus $100 insufficient); *Zimmerman v. Unemployment Comp. Bd. of Review*, 836 A.2d 1074 (Pa. Commw. Ct. 2003)(continued employment and $10 insufficient).
   2. To all employees, or just where states require it?
   3. Any ability to tie to equity grant, allow for clawback or forfeiture?

iv. What are you going to do with employees who refuse to sign? Are your operations people going to "buy in" to terminating for failure to sign? Ditto re: refusal to hire.
    1. Beware of "spin-back" claims (California).
v. Who is going to field questions from employees? What if employees direct legal questions to in-house counsel?

e. **Number Five**: Research.

i. Is there a seminal case in your industry "blessing" particular language? Or, a "bad" case suggesting that a noncompete in your industry would rarely be appropriate?
ii. Have your competitors been involved in litigation? How did their noncompete fair? What does it look like?

**3. Five Things *To Think About*As You Write.**

a. **Number One**: What Law Will Apply?

i. State variations, including state statutes. Take advantage of any presumptions of reasonableness.
ii. Is ERISA preemption an option (top hat plans, etc.)?
iii. Choice of law provisions. Alone or in conjunction with mandatory venue provisions.
    1. Common test: RESTATEMENT OF CONFLICT OF LAWS, Section 188. Choice of law enforced unless
        a. Chosen state has no substantial relationship to parties or transaction and no other reasonable basis for parties' choice; or
        b. Application of chosen state law would be contrary to fundamental public policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which would otherwise be the state of the applicable law.
iv. Any industry/type-of-relationship issues?
    1. Doctor
    2. Attorneys
    3. Broadcasting
    4. Independent contractors
        a. Exercise of control
    5. High-level executives
    6. Etc.

b. **Number Two**: What Stance Do Courts Take On Reformation?

i. All or nothing? Strike-through?Judicial modification?

1. Arkansas, Nebraska, Virginia, and Wisconsin have published decisions indicating a relatively high risk of an "all or nothing approach.
2. Alabama, Alaska, Delaware, Florida, Georgia, Illinois, Iowa, Kansas, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nevada, New Hampshire, New Jersey, New York, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, Tennessee, Teas, Vermont (possibly), Washington, West Virginia, and Wyoming have all indicated a willingness to reform (modify) an otherwise enforceable provision.
3. On the other hand, Arizona, Colorado, Idaho, Indiana, Louisiana, Maryland, North Carolina, South Carolina and South Dakota follow a blue pencil or strike through approach.
    a. Important to research state law to determine how far these jurisdictions will take this power.
    b. Important to include severability provision.

ii. Narrowly tailor or rely on court's intervention
iii. Danger of over-reaching
iv. Draft to allow severability

c. **Number Three**: <u>How To Deal With Diverse Businesses</u>?

i. What to do about companies with diverse business lines—either your client's business or that of the competitor.
ii. Both in the noncompete and customer nonsolicitation provision.

d. **Number Four**: <u>WouldNoninterference Provisions Be Valuable In Addition To Or Instead Of a Non-Compete?</u>

i. Employees
    1. Difficulty of proving damages in at-will context.
    2. Consider liquidated damages provision. But, beware of danger of "pay to play."
ii. Customers
iii. Business referral sources. Case law is split.
    1. Florida and Louisiana have cases suggesting referral sources are not legitimately protectable. *Florida Hematolog y & Oncology v. Tummala*, 927 So. 2d 135, 139 (Fla. Dist. Ct. App. 2006); *Restivo v. Hanger Prosthetics & Orthotics, Inc.*, Civil Action No. 06-32, 2007 WL 1341506 (E.D. La. May 4, 2007).
    2. The Kansas Supreme Court found otherwise. *Idbeis v. Wichita Surgical Specialists, P.A.*, 112 P.3d 81, 86 (Kan. 2005).
iv. Suppliers/Vendors
    1. Some cases have enforced. *See, e.g., North Pacific Lumber Co. v. Moore*, 275 Or. 359, 551 P.2d 431, 434 (1976).

e. **Number Five**: What Is The Appropriate Scope of The Noninterference Provisions?

i. Contactrequirement?
    1. "All customers" restrictions vulnerable to attack. *Capricorn Sys., Inc. v. Pednekar*, 248 Ga. App. 424, 427, 546 S.E.2d 554 (2001) ("The nonsolicitation of customers covered any and all customers of the plaintiff, regardless of whether defendant had ever worked for them or had any relationship established during employment anywhere. Therefore, such provision was void as overly broad and unreasonable… .").

ii. Within a geography/territory?
    1. Arizona case law suggests that noninterference provisions require a geographic limitation.*See Varsity Gold, Inc. v. Porzio*, 45 P.3d 352, 356 (Ariz. 2002); *Wright v. Palmer*, 11 Ariz. App. 292, 464 P.2d 363 (1970).
    2. Louisiana requires a geographic limitation phrased in terms of specific parishes. LA. REV. STAT. §23.921(C) (stating that a restrictive covenant must specify the "parish or parishes, municipality or municipalities, or parts thereof," in which the covenant is to operate).

iii. Current vs. former?
    1. Several states take the position that employers have no protectable interest in past customers or customers that are lost through no action or wrongdoing by their employees. *See, e.g., Hilb, Rogal & Hamilton Co. of Ariz., Inc. v. McKinney*, 946 P.2d 464, 467 (Ariz. Ct. App. 1997); *Hahn v. Drees, Perugini & Co*., 581 N.E.2d 457, 461 (Ind. Ct. App. 2d Dist. 1991).

iv. Prospective?
    1. Many courts have recognized that, in some circumstances companies have a legitimate interest in prohibiting a departing employee from soliciting prospective customers. *See, e.g., Ikon Office Solutions, Inc. v. Usherwood Office Tech., Inc.*, No. 9202-08, 2008 WL 5206291, at * 15 (N.Y. Sup. Ct. Dec. 12, 2008); *International Sec. Mgmt. Group, Inc. v. Sawyer*, 2006 WL 1638537, at *14–15 (M.D. Tenn. June 6, 2006).
    2. Define the term "prospective customers" so that it cannot be interpreted as encompassing the universe of potential customers. *See, e.g., Trailer Leasing Co. v. Associates Commercial Corp.*, 1996 WL 392135, at *5 (N.D. Ill. July 10, 1996) (nonsolicitation clause's "restriction of 'prospective' customers—a term left undefined and potentially all-encompassing—is also too broad.").