

Are Your Noncompete Agreements Dying of Old Age?

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Key Points

- Tight labor markets are leading courts and legislatures to closely scrutinize noncompetes and other restrictive covenants.
- If there are changes in an employee's job and/or the company's business, it may be prudent to proactively amend or supplement the existing standardized documents to prophylactically further shield the company against threats to its customer relationships, employees and confidential information.
- Regular review and maintenance can help maximize employers' ability to protect their businesses against breaches of former employees' contractual agreements and unfair competition.

Noncompetition and other restrictive covenants provide valuable protection against unfair competition from departing employees. However, legal developments and changes in an employee's job or the nature of the company's competition can cause employers' restrictive covenant agreements to become outdated and potentially unenforceable. Periodic review and maintenance of these agreements is crucial to ensure employers get the maximum available legal protection from theft of their customer base and business opportunity, employee talent and confidential information.

The Effect of Statutory Changes

Because they impede employees' ability to change jobs freely, noncompetition agreements, as well as provisions barring solicitations of former customers or employees, often are subject to more stringent rules than ordinary contracts. Some states, like California, Oklahoma, Montana and North Dakota, effectively ban noncompetition agreements altogether outside the context of the sale of a business. Others, like Colorado, Georgia, Louisiana, Massachusetts and Oregon and soon Washington state, limit the types of workers to which they can apply or require that other elements be present.

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Among some of the recent and noteworthy state statutes are:

Washington: Effective January 1, 2020, only employees who earn more than \$100,000 per year and independent contractors who earn more than \$250,000 per year (both amounts to be adjusted annually for inflation) can be subject to a noncompetition covenant. Noncompetition covenants lasting longer than 18 months will be presumptively invalid. The terms of a noncompetition covenant must be disclosed to a prospective employee in writing no later than the time the employee accepts an offer of employment, and covenants entered into during an employee's employment must be supported by independent consideration. To enforce a noncompetition covenant against an employee terminated in a layoff, the employer must provide compensation equivalent to the employee's base salary at the time of termination, minus compensation earned through subsequent employment, during the period of enforcement. If a court or arbitrator determines that a noncompetition covenant violates the new law, or is only partially enforceable, the employer may be liable for financial penalties and legal fees.¹

Oregon: Noncompetition agreements must meet the following criteria: (i) the employee is exempt from minimum wage and overtime as a "white collar" employee (i.e., he or she fits into either the executive, administrative or professional exemption); (ii) at termination, the employee's annual salary and commissions exceed the median family income for a family of four as determined by the U.S. Census Bureau; (iii) the employer has a "protectable" interest in the form of the employee's access to trade secrets or competitively sensitive confidential business or professional information, such as product development plans, product launch plans, marketing strategy or sales plans; (iv) the agreement is entered into at the beginning of employment (or bona fide advancement), and the employer has provided a written notice to the employee at least two weeks before employment begins that a noncompetition agreement will be required; and (v) the agreement is not effective for longer than 18 months from the date of the employee's termination. If an employee is not exempt and does not meet the salary test, a noncompete may be enforceable if, during the restricted period, the employer pays the departed employee at least 50 percent of the employee's annual salary and commissions at the time of termination or 50 percent of the median family income for a family of four, whichever is greater.² Effective January 1, 2020, the employer also must provide the employee with a signed, written copy of the terms of the noncompetition agreement within 30 days after the employee's termination date.³

Massachusetts: To be enforceable, a noncompete agreement must meet statutory requirements with respect to legitimate business interests and reasonableness and must: (i) be in writing and signed by both parties; (ii) state that the employee has the right to consult with counsel prior to signing; (iii) be provided to the employee 10 business days in advance (or at the time of a formal employment offer, if earlier); and (iv) satisfy consideration requirements, such as a garden leave clause. Agreements entered into during an employee's employment must be supported by fair and reasonable consideration independent from the continuation of employment. Noncompetition agreements are not enforceable against employees classified as nonexempt under the Fair Labor Standards Act, student interns, employees who have been terminated without cause or laid off or employees age 18 or younger.⁴

Colorado: Noncompetition provisions that restrict the right of any person to receive compensation for performance of skilled or unskilled labor for any employer are generally prohibited, except in the cases of: (i) contracts for the purchase and sale of a

business or the assets of a business; (ii) contracts for the protection of trade secrets; (iii) provisions authorizing recovery for education and training expenses of an employee who has served that employer for less than two years; and (iv) executive and management personnel and officers and employees who serve as professional staff to executive and management personnel.⁵

Georgia: Noncompetition restrictions are not permitted against employees who do not: (i) have a primary duty of managing the enterprise or of a customarily recognized department or subdivision, regularly direct the work of two or more other employees and have the authority to hire or fire other employees or have particular weight given to suggestions and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees; or (ii) perform the duties of a key employee or of a professional, as defined by the statute. Among other provisions, restrictions of up to two years are presumptively reasonable.⁶

Louisiana: Noncompetition and nonsolicitation of customers provisions are generally void against employees unless they strictly comply with the statute's requirements, including: (i) listing the geographic area of prohibition by parishes, municipalities or parts thereof; and (ii) not exceeding a period of two years from termination of employment.⁷

These recent statutory changes reflect a growing trend, as state legislatures are setting more stringent standards as to which employees may be subject to noncompete agreements and the terms that employers may impose upon them. Employers that have not kept up with these changes may find their restrictive covenants to be outdated and unenforceable.

The Impact of Changing Roles and Evolution of the Employer's Business

Even in states where there has been no statutory activity, changes in an employee's job or the underlying competitive landscape can affect the scope of enforceability of noncompete agreements. Post-employment restrictions on working for a competitor or soliciting former co-workers or customers are contracts that must satisfy the usual elements of an enforceable agreement, including a valid offer, acceptance of the offer and consideration to support the parties' agreement. They also are subject to common law defenses to the enforcement of a contract. A recent Massachusetts case demonstrates how job changes can affect enforceability under these principles.

On May 31, 2019, a federal court in Massachusetts denied a request for an injunction by Sodexo Operations, LLC to prevent a former senior vice president from working for a Sodexo customer, where he would allegedly oversee the transition of the customer's work to a Sodexo competitor. The court based its decision in part on the so-called "changed circumstances doctrine," observing that material changes to the defendant's job and compensation raised doubts about the continued enforceability of his noncompetition agreement.⁸

Although it was decided at the injunction stage before the development of a full record, the court observed that there were several material changes in the former employee's compensation and job responsibilities between 2005 when he signed the noncompete and his 2019 resignation, and that a 2014 offer letter for a new position made no reference to the 2005 noncompete. Promotions, compensation adjustments and other alterations to an employee's pay or job responsibilities can result in changes that

potentially supersede a prior agreement in which an employee may have agreed to a noncompete covenant or other restriction.

Changes in the nature and identity of competitors, the goods and services a company offers, the geographic footprint of the business or the company's customer base also may affect the scope of effectiveness of protections in a restrictive covenant agreement. For example, a company's customer base or area of operations might extend beyond the geographic limitations specified in a noncompetition or nonsolicitation provision. Similarly, a company might develop new lines of business that are not captured in the scope of its restrictive covenant's description of prohibited activity or face new or emerging competitors, like online sellers, that may not be captured within the definition of a competitor.

A Rhode Island federal district court's recent decision in *CVS Pharmacy, Inc. v. Lavin* illustrates the importance of properly defining competitors in light of the changing face of competition.⁹ On June 18, 2019, the *Lavin* court granted CVS a preliminary injunction to enforce a noncompete covenant against a senior executive who left the company to work for PillPack, a mail-in retail pharmacy owned by Amazon. The court concluded that PillPack was a competitor of CVS even though it is considered a retail pharmacy and CVS Caremark is a pharmacy benefits manager (PBM) because the agreement defined competitor to include all levels of business, including both PBM and retail. At the same time, the covenant was narrowly tailored to protect CVS's legitimate interests, as it only precluded the executive from providing services that are "the same or similar in function or purpose" to the services he provided to CVS or would likely result in the disclosure or use of confidential information (as opposed to prohibiting the executive from engaging in *any* activity for a competitor).

Unlike statutory changes, determining whether changed circumstances will affect the enforceability of a noncompete is more fact-intensive. Regular review of standardized noncompete agreements, with an eye toward whether the terms still adequately cover a company's evolving business, makes practical sense and can help employers ensure that the agreements are both enforceable and effective.

Protectable Interest, Reasonableness of Restrictions and Reformation

In addition to adherence to applicable statutory restrictions and requirements, courts generally require that restrictive covenants support a legally recognized employer interest and be reasonable in terms of the time, scope and geography of the activities they restrict.

Protectable Interest. Because noncompete and other restrictive covenants limit the ability of workers to move freely, the law in most states requires that an employer have a specific interest in implementing such restrictions. Recognized protectable interests, which are often specifically enumerated by statute and vary state-to-state, can include the employee's access to trade secrets, confidential or proprietary information, protected customer lists or the like. Protectable interests can also include use of employer goodwill, retention of employees or customers, specialized training provided by the employer to the employee or other unique investments the employer makes in the employee.

The recent success of the Illinois and New York attorney general offices in challenging Jimmy John's use of noncompete agreements for sandwich makers and delivery drivers shows the risk of overreaching. The company required its hourly employees to

sign noncompete agreements that prohibited them for a two-year period post-employment from working at another business within a two-mile radius of any Jimmy John's location (regardless of the location at which the employee worked) that made more than 10 percent of its revenue from selling submarine or deli-style sandwiches. The attorneys general alleged that Jimmy John's had no legitimate business interest to justify the noncompete agreements, as the hourly employees did not have near-permanent customer relationships and did not acquire trade secrets or other proprietary information.¹⁰ These challenges highlight the importance of accurately and proactively identifying the legitimate interest an employer is seeking to protect through its use of restrictive covenants (and not unnecessarily overreaching).¹¹

Reasonableness. State laws also generally require that limitations on activities be reasonable in time, scope and geography, and not broader than necessary to protect the employer's legitimate interest.¹² Similarly, courts are generally more willing to enforce restrictions that are limited in terms of the duration, scope of prohibited activities and geographic footprint. Some state laws contain express requirements as to these limitations, such as a maximum restrictive period, and others contain rebuttable presumptions of reasonableness.

Restrictions barring a worker from soliciting prior clients or co-workers can often be easier to justify than broader prohibitions on competition that prevent someone from certain employment altogether.¹³ A covenant not to solicit that prohibits an employee from soliciting customers with whom the employee had contact or about whom the employee had confidential information is even more likely to be upheld. It would also likely not be subject to the same geographic limitations as a noncompetition obligation.

Reformation. Many states allow courts to reform (blue pencil) or strike (red pencil) an overly broad restriction on the duration, scope of prohibited activity or geographic limit. Nonetheless, proactively reviewing the company's standardized agreements to ensure they are capturing the company and/or employee's possibly changing scope of activities is preferable. Moreover, reformation may limit the remedies available to the employer,¹⁴ and some states will require an employer to pay the attorney's fees incurred by an employee in a situation in which the employer is found to have sought to enforce an agreement that it knew at the time of execution contained unreasonable restrictions.¹⁵

Conclusion

Against the backdrop of rapid evolution in many industries, changing competition and historically low unemployment, courts and legislatures are closely scrutinizing employer restrictive covenants. A regular and critical look at the covenants an employer utilizes with employees can help ensure that valid restrictions remain valid and provide ample protection against unfair competitive threats.

1 H.B. 1450, 66th Leg., Reg. Sess. (Wash. 2019).

2 Or. Rev. Stat. § 653.295.

3 H.B. 2992, 80th Leg., Reg. Sess. (Or. 2019).

4 Mass. Gen. Laws ch. 149 § 24L.

5 Colo. Rev. Stat. § 8-2-113(2).

6 Ga. Code § 13-8-53.

7 La. Rev. Stat. § 23:921.

8 *Sodexo Operations, LLC v. Abbe*, No. 19-11015-RWZ, 2019 WL 2330464 (D. Mass. May 31, 2019).

9 *CVS Pharm., Inc. v. Lavin*, No. 19-204-JJM-PAS, 2019 WL 2515781 (D.R.I. June 18, 2019).

10 *People v. Jimmy John's Enter., LLC*, No. 2016-CH-07746 (Ill. Cir. Ct. June 8, 2016); *A.G. Schneiderman Announces Settlement with Jimmy John's to Stop Including Non-Compete Agreements in Hiring Packets*, N.Y. Attorney Gen. (June 22, 2016), <https://ag.ny.gov/press-release/ag-schneiderman-announces-settlement-jimmy-johns-stop-including-non-compete-agreements>.

11 See Harriet Torry, *Interns' Job Prospects Constrained by Noncompete Agreements*, Wall Street Journal (June 29, 2019), <https://www.wsj.com/articles/interns-job-prospects-constrained-by-noncompete-agreements-11561800600>.

12 See, e.g., *Legal Tech Grp. v. Mukerji*, 2019 U.S. Dist. LEXIS 97011, at *16 (D.D.C. June 10, 2019) ("Restrictions are unreasonable if 'the restraint is greater than is needed to protect the promisee's legitimate interest, or . . . the promisee's need is outweighed by the hardship to the promisor and the likely injury to the public.'" (quoting *Mercer Mgmt. Consulting, Inc. v. Wilde*, 920 F. Supp. 219, 237 (D.D.C. 1996))).

13 *Id.* ("[A] 'restraint is easier to justify . . . if the restraint is limited to the taking of [a] former employer's customers as contrasted with competition in general.'" (quoting *Mercer*, 920 F. Supp. at 237)).

14 See, e.g., Tex. Bus. & Com. Code § 15.51(c) ("[T]he court shall reform the covenant to the extent necessary to cause the limitations contained in the covenant as to time, geographical area, and scope of activity to be restrained to be reasonable . . . and enforce the covenant as reformed, except that the court may not award the promisee damages for a breach of the covenant before its reformation and the relief granted to the promisee shall be limited to injunctive relief.").

15 See, e.g., *Sentinel Integrity Sols., Inc. v. Mistras Grp., Inc.*, 414 S.W.3d 911 (Tex. App.—Houston [1st Dist.] 2013, pet. denied) (awarding employee \$750,000 in attorney's fees for defending employer's action to enforce noncompete).

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