How to Make Non-Competes Not Worth the Paper They Are Written On

By: Christopher E. Hannum and Stanton P. Geller

Non-competition covenants ("Non-Competes"), also known as covenants not to compete, can be a powerful tool in protecting key employees, customers, accounts, suppliers, products and services, market share, confidential information and other proprietary assets. Generally, Non-Competes are strictly construed by courts and generally looked upon with disfavor as they arguably restrain competition and restrict an individual's ability to earn a living. It is therefore not only critical to use a well-crafted Non-Compete[1] to maximize its enforceability in the applicable jurisdiction, but to take appropriate action (and inaction) when a Non-Compete exists. Unfortunately, many Non-Competes are rendered worthless by the ill-advised actions of employers and their agents. Below are the top ways in which employers can (and have) jeopardized their Non-Competes. While this article is written primarily with North Carolina law in mind, many concepts also apply in other states.

1. Do Not Put it in Writing.

Many states, including North Carolina, will not enforce Non-Competes unless such covenants are in writing and a part of the employment "contract," which is basically understood as the employment relationship as a whole. Therefore, any reliance on a verbal understanding will not hold up. Even if other employment terms are covered in generalities, it is preferable to have new and existing employees enter into a formal employment agreement containing a Non-Compete, along with other terms of employment.

2. Don't Pay Adequate Consideration.

For new employees, the mere promise or act of new employment is generally sufficient consideration to support a Non-Compete. New employees should therefore execute their employment agreement with a Non-Compete prior to or contemporaneously with the time of starting employment. If an existing employee (including an employee who has worked for merely one minute) signs an agreement with a Non-Compete, generally new and non-illusory consideration is required to enforce the agreement. This can be in the form of a cash payment that is not otherwise owed to the employee, or other new and material consideration. It is not enough to simply state in the agreement that adequate consideration was provided. The danger of using a stand-alone Non-Compete is that it may intentionally or unintentionally be executed after the initial employment date and therefore, may fail without new and adequate consideration.

[1] Note that by statute, North Carolina requires that covenants not to compete be in writing signed by the person against whom the restriction is to be enforced (N.C. Gen. Stat. §75-4).

3. Use a Broad and Arbitrary Territory Restriction.

Territory and the time restraints are generally the most litigated matters for Non-Competes. A Non-Compete territorial restriction should be reasonable in scope and germane to where the employer is actively engaged in business, where services are performed, and the location of customers among other variables. Failure to include a well-reasoned, logical geographic limitation, or simply referencing a blanket geographic restriction ("anywhere in the United States") can cause a Non-Compete to be unenforceable. One size does not fit all. Attention must be made to whether the territory will be based on, for example, the location of competitors and/or the location of customers. In addition, the drafter of the Non-Compete must be aware of the judicial and statutory tests to determine if the territory is reasonable or overly restrictive with respect to the subject employee.

4. Do Not Include Customer and Supplier Non-Interference Covenants.

With respect to employees who have specific account relationships in particular, it is advisable for employers to identify those accounts in the employments agreement and include non-interference covenants that restrict post-employment contact with such accounts. Courts are more likely to respect covenants that protect proprietary assets (customer relationships, vendors and accounts) rather than merely restricting employees from other employment. Non-interference covenants generally do not require territory restrictions (although such terms can be advisable at times), and can provide employers with remedies against former employees in the event that Non-Competes are not included or respected. Non-interference covenants should be separately stated to increase the chance that such covenants will be enforced even if the Non-Compete terms are not enforceable.

5. Leave Blanks in Your Documents or Fill-in Blanks at a Later Time.

It is important to complete all open fields in the Non-Compete before the parties execute it. It sounds simple, but on numerous occasions we have seen employers execute Non-Competes that have incomplete terms, with the idea that the blanks will be completed in due course (once all accounts are identified, etc.). Unfortunately, leaving blanks creates uncertainty and leaves the impression that the parties did not reach an agreement with respect to the Non-Compete. Likewise, the employer and employee may later agree to changes in accounts, territories and other employment terms, without corresponding updates to Non-Competes. In many cases, the documents are tucked away by "HR people" and never completed, leaving the employer with incomplete, obsolete and/or oftentimes unenforceable documents.

6. Do Not Keep All Counterpart Signature Pages.

The employer may need to present a fully executed agreement if the matter goes to court. Yes, it sounds simple, but many documents are tucked away and lost through poor record

keeping systems, inexperienced staff, office relocations and turnover in human resources staff. Failure to follow up and pay attention to detail can derail any Non-Compete.

7. **Do Not Worry About Differing State Laws**.

Though there are many similarities among the states, each state has developed its own law on Non-Competes. For instance, California severely limits Non-Competes for employees and Louisiana has very specific requirements for designating territory restrictions. Importantly, the governing law stated in the document does not always control, particularly if the employee resides and/or performs services in another state, or executes the agreement in another state. Great care should be taken where and how the agreement is executed so that the choice of law (which state law governs) in the agreement is respected.

8. **Ignore the Agreement's Terms.**

Oftentimes Non-Competes will require some up front monetary payment as partial consideration for the Employee's agreement to its terms. It is very simple. If you desire to enforce your Non-Compete, be sure that you are first in compliance with its terms. Not timely paying in full to the employee the monetary consideration for entering into the Non-Compete and not following through on all notice and other provisions within the Non-Compete will undermine your efforts. If you don't respect the Non-Compete, do not expect a judge to do so.

9. **Let Your HR People Torpedo Your Efforts**.

It is naturally unwise to provide other communications (memos, emails, employee handbooks, etc.) to employees that contradict provisions in the Non-Compete. Yet we see this quite often. For example, one employer informed an employee that the employer would not enforce the Non-Compete if the employee was terminated without cause. Employers should be aware of what is being communicated to employees who are subject to Non-Competes.

10. **Get Everyone to Sign a Non-Compete.**

If you are not concerned about a non-key employee going to a competitor, or if a Non-Compete with an employee is not protecting a legitimate business interest, then do not ask the employee to enter into a Non-Compete. Do you really need the receptionist to sign a Non-Compete? You probably do not. It sends the message that you are not truly interested in protecting the truly proprietary assets of the employer, and weakens your credibility in enforcing Non-Competes against those employees who are more critical to your operation. If you are worried about the disclosure of confidential information by lower level employees, it is typically sufficient and desirable to have such employees sign trade secret protection and confidentiality agreements that allow you to protect your legitimate business interests without preventing someone from earning a livelihood.

11. Ignore Employee Breaches.

Failure to consistently enforce your Non-Competes against terminated employees may be deemed a waiver of or may jeopardize your rights to enforce Non-Competes against other employees. Employers often pick and choose what Non-Competes to enforce, depending on the importance of the former employee, the mood of the employer and the facts of the case. Failing to consistently enforce a Non-Compete can severely weaken your case against the ones that you want to enforce. It also puts existing employees on notice that you do not respect the Non-Compete and have no intention of enforcing it if employees leave.

12. Threaten Your Employees.

Do not threaten your employees or otherwise coerce them into signing Non-Competes. Using threatening or strong-arm tactics with your employees to enter into the Non-Compete only gives them incentive to contest its validity based on duress. A judge may throw out the entire agreement under such circumstances.

13. Ignore Changes in the Law

Unfortunately, the law on Non-Competes is frequently subject to inconsistent or evolving court opinions on the parameters and enforceability of Non-Competes. It is not good enough to know the judicial landscape from the past. The drafter of the Non-Compete must be up-to-date on any material changes in the law in order to put the employer in the best position to withstand judicial scrutiny.

Each year, employers spend millions of dollars to prevent the theft of tangible assets, but make little or no effort to protect, in many cases, the most valuable part of their business -- intangible assets, such as customer relationships, goodwill, and proprietary know-how. By properly utilizing and implementing a Non-Compete, non-interference covenants and/or confidentiality provisions, you can provide added protection against your most valuable assets. Furthermore, if something is worth doing, it is worth doing right. It makes business sense to properly craft a Non-Compete to stand-up to the many hurdles that an employer can encounter in enforcing Non-Competes.[2]

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[2] While this article focuses primarily on the employment context, restrictive covenants can also be used with certain independent contractors, in the business-to-business context and in the sale of business context (to protect the buyer's investment and to prevent the seller from competing with or soliciting customers or employees of the buyer). Many of the same principles set forth above (respectfully the Non-Compete, documentation, etc.) also apply in such other contexts.

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