

Effective Use of Employee Non-Compete, Non-Solicit, and Confidentiality Agreements



Presented By
Matt Stiles & Matthew Cannova
Maynard, Cooper & Gale, P.C.
February 2023



Agenda

- ▼ **Overview of Types of Agreements**
- ▼ **Legal Standards for Enforceability**
- ▼ **Federal Trade Commission Proposed Rule**
- ▼ **Best Practices for Effective Use**

Overview of Types of Agreements

▼ Confidentiality Agreements

- ▼ Premise: employee **needs access** to employer info
- ▼ Protection of employer's confidential **trade secrets, customer information, proprietary information, special sauce, etc.**
(information to be kept confidential)
- ▼ Addresses both **authorized and unauthorized** uses of such information
- ▼ Might be combined with **Intellectual Property Rights** agreement, by which employee acknowledges inventions and creations pursuant to employment are property of employer and any individual rights are "**assigned**" to employer
- ▼ May also be based on statutory rights/duties: **PII laws, HIPAA, uniform trade secrets acts**
- ▼ **Generally does not prohibit employment with a competitor or solicitation of former employee's customers, employees, etc.**

Overview of Types of Agreements

▼ **Non-Solicitation**

- ▼ Premise: employee **needs access** to employer info
- ▼ Protection of **employer's relationships** and good will associated with those relationship
 - ▼ Customers
 - ▼ Employees
 - ▼ Vendors/Business Partners
- ▼ Does not prohibit employment with a competitor, but restricts **what former employee can do in that employment**

Overview of Types of Agreements

▼ **Non-Compete**

- ▼ Premise: employee **needs access** to employer info
- ▼ Protection of **employer's from its own information** being used by a former employee to gain a competitive advantage
- ▼ Prevents former employee from **being employed or otherwise associated** with another business that competes against the employer in the same industry

Legal Standards for Enforceability

▼ General Standards

- ▼ To be enforceable, Confidentiality, Non-Solicitation, and Non-Compete Agreements must be:
 - ▼ **In writing and signed by both parties**
 - ▼ Supported by **consideration that is clear on the face** of the Agreement
 - ▼ Consideration: A quid pro quo = this for that
 - ▼ An offer of employment
 - ▼ Continued employment
 - ▼ Promotion
 - ▼ Cash or a benefit not otherwise owed

Legal Standards for Enforceability

▼ State-Specific and Judge Driven Law

- ▼ There currently is **no federal law** governing the enforceability of typical confidentiality, non-solicitation, and non-competition agreements
- ▼ States have jurisdiction over these agreements since the emergence of **state law** in the U.S.
 - ▼ Statute
 - ▼ Common law (court precedent)
- ▼ Most lawsuits to enforce these agreements are **filed in state courts before state judges** (except for cases between parties of two different states that are valued at \$75,000 or greater, which may be filed in federal court)
- ▼ Most state court judges are **elected** by the local population
- ▼ Most state court judges think **employers are too heavy handed** with these agreements
- ▼ State court judges look out for **victims**
- ▼ **The bigger your footprint, the broader the range of law** your agreement must comply with in order to be enforceable
- ▼ **Choice of law** provisions in non-competes not always enforced

Legal Standards for Enforceability

▼ Confidentiality

- ▼ The most **widely used** by employers and subject to the **least stringent legal review**
- ▼ **To be enforceable by a court:**
 - ▼ Protected information must be **clearly defined** and limited to information that **belongs to the employer** or the employer has a **right/duty** to protect, and does not include publically available information
 - ▼ May require protection for an indefinite or unspecified period of time
 - ▼ Must include reasonable **safe harbors** required for whistleblowers:
 - ▼ **Dodd-Frank** – reporting securities fraud or cooperating with federal and state investigatory agencies
 - ▼ **FAR/DFAR** – reporting fraud, waste, or abuse
 - ▼ **Defend Trade Secrets Act** – pursuant to subpoena, court order, and the like

Legal Standards for Enforceability

▼ Non-Solicitation

- ▼ Subject to **heightened standard** of legal review
- ▼ Restrictions must be **tailored to a protectable interest**
- ▼ **Protectable interest:** information/relationships of a non-public nature that are owned or safeguarded by the employer and all of which are **utilized by the employee** during the course of employment
- ▼ **Reasonable in scope:** limited only to relationships that the employee gained, serviced, or obtained confidential information about during the course of employment
- ▼ **Reasonable in duration:** the length of the restriction should be commensurate with the cycle of relationships in the industry
 - ▼ 1 year: almost always ok
 - ▼ 2 years: tougher to prove
 - ▼ >2 years: difficult to prove

Legal Standards for Enforceability

▼ Non-Competition

- ▼ Subject to **strictest standard** of legal review
- ▼ Restrictions must be **tailored to a protectable interest**
- ▼ **Protectable interest:** information/relationships of a non-public nature that are owned or safeguarded by the employer and all of which are **utilized by the employee** during the course of employment
- ▼ **Reasonable in scope:** limited only to the industry segment in which the employee worked for the employer and in which the employer has on-going business
- ▼ **Reasonable in duration:** the length of the restriction should be commensurate with the turnover of employment in the industry
 - ▼ 1 year: almost always ok
 - ▼ 2 years: tougher to prove
 - ▼ >2 years: difficult to prove

Legal Standards for Enforceability

▼ Nuances for Sale of Assets/Business

- ▼ Most law about confidentiality, non-solicitation, and non-competition agreements **results from employment** relationships
- ▼ Courts tend to view post-employment restrictions associated with a **sale of assets or a business much more favorably for the enforcing party** because of the necessity of preserving the value of what has been sold/acquired
- ▼ Historically, it would not be unusual to see courts uphold non-solicitation and non-competition agreements with a **5-year** duration following the sale of assets/business.

Federal Trade Commission Proposed Rule

- ▼ January 5, 2023, **Federal Trade Commission** proposed a rule to **eliminate use of non-compete agreements** (including any subset like non-solicitation or confidentiality agreements that have a **similar substantial restraint on employment mobility**)
- ▼ Rule would **apply to employees**, independent contractors, consultants, paid and unpaid interns/volunteers, and **virtually any other worker**
- ▼ Upon the rule becoming final, **business would have to affirmatively notify** individuals subject to such an agreement that it is no longer in effect
- ▼ As proposed, the rule would **not apply in the context of a sale of assets** as applied to the seller (or substantial partner in the sale) of those assets

Federal Trade Commission Proposed Rule

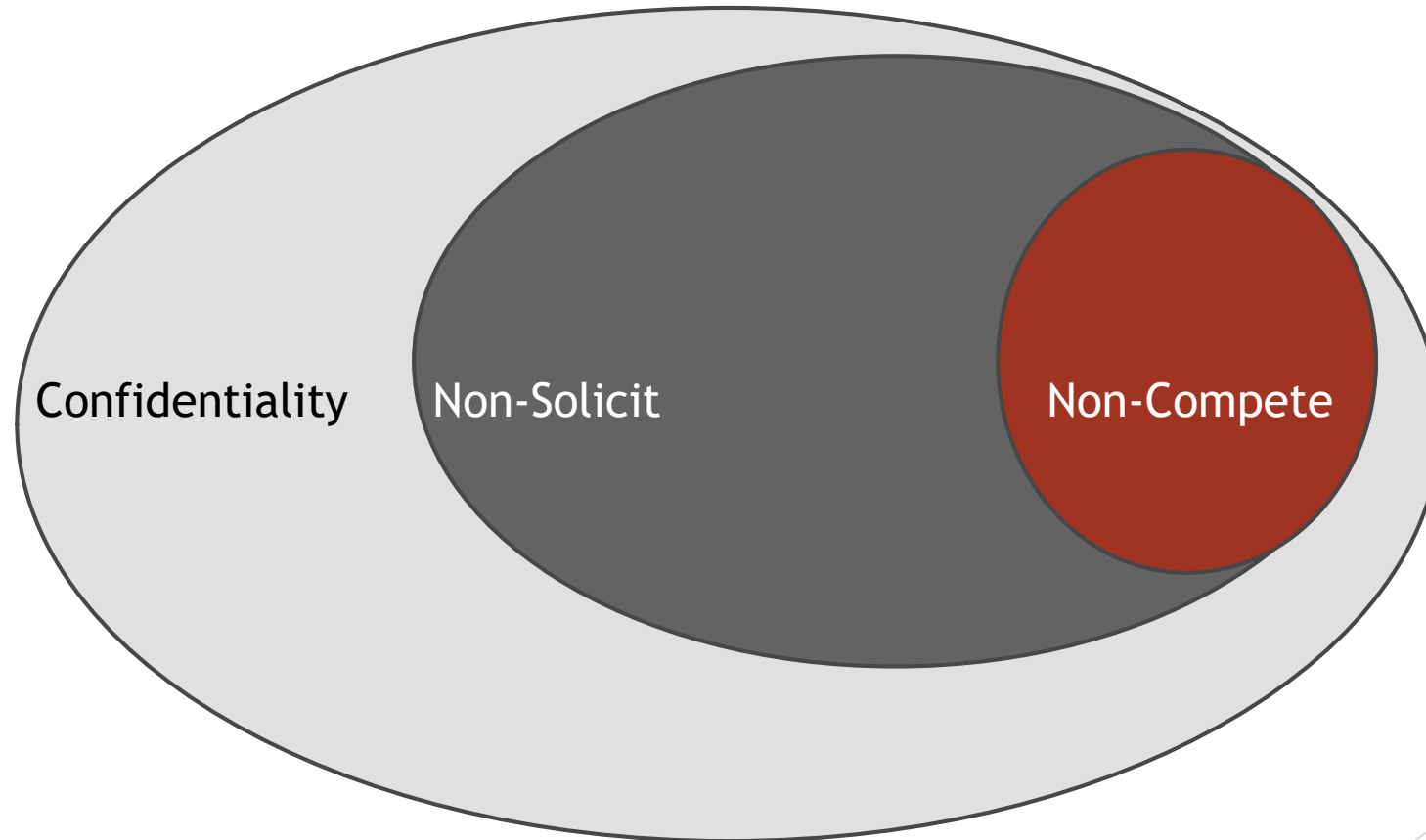
- ▼ Public comment period is open until early March 2023

<https://www.regulations.gov/docket/FTC-2023-0007/document>

- ▼ **Will FTC ever publish a final rule?**
- ▼ Substantial legal challenge would be expected and likely to thwart the rule
- ▼ What legislative changes might occur to pre-empt or align with the proposed rule

Best Practices for Effective Use

- ▼ Consider the needs of your organization based on the difficulty of the legal standards and scrutiny on each class of document:



Best Practices for Effective Use

- ▼ Once you've customized your agreements for the level of personnel, customize them further for the state law in which you/they work
- ▼ The broader your geographic footprint, the less likely you can use a one-size-fits-all agreement
- ▼ **State law considerations:**
 - ▼ **Virtually impossible** to enforce a non-compete in CA, OK, ND, and DC, except for sale of business/assets
 - ▼ CO, IL, ME, MD, NH, OR, RI, VA, and WA: only allow non-competes for specified **higher income workers**
 - ▼ TX – non-competes must be “**ancillary to an otherwise valid contract**” in order to be enforceable
 - ▼ Some states will not allow “**continued employment**” to be adequate consideration
 - ▼ Some states prohibit non-competes that would limit “**professionals**”

Best Practices for Effective Use

- ▼ Protect the likelihood of future enforcement by adding a “**blue pencil**” provision that authorizes any reviewing court **to reform** any invalid, void, or unenforceable provision of the contract to its **maximum lawfully enforceable restriction**, but not all courts will recognize such a provision
- ▼ Try to use **choice of law and choice of venue** provisions in your agreements for the best chance at a consistent application of law to the enforcement of your agreements, but know it won't be enough everywhere

Best Practices for Effective Use

- ▼ Have a **single gatekeeper** for your organization's use of these agreements to ensure consistency in how they are used and what changes are permitted
- ▼ Your gatekeeper should request at least an **annual review** of your form agreements by legal counsel to update them for any changes in applicable law
- ▼ Have a **practical system** for obtaining signed copies (whole agreements, not just signature pages), making sure they contain signatures for both the employee and the company, and filing/retaining them

Best Practices for Effective Use

- ▼ If your organization considers the use of confidentiality, non-solicitation, and non-competition agreements to be essential to your business, be sure to file a public comment on the FTC rule:

<https://www.regulations.gov/docket/FTC-2023-0007/document>

- ▼ And stay tuned...

Action Items

- ▼ **At least annually:**
 - ▼ **Review your strategy** for which classification of employee you require to sign which type of agreement
 - ▼ **Audit your files** where signed copies of those agreements are maintained to ensure they are up-to-date, stored in one piece (and legible), and contain both signatures for each current employee
 - ▼ **Request legal counsel review** for the geographic locations where those employees work to make sure your agreements have the highest likelihood of enforcement



MAYNARD
COOPER GALE

ALABAMA | CALIFORNIA | FLORIDA | NEW YORK | TENNESSEE | TEXAS | WASHINGTON DC

MAYNARDCOOPER.COM