Costly Mistakes Employers Make with Their Non-Competition Agreements. Plus: Looking Ahead to Biden's Push to Increase Competition

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Many employers utilize "restrictive covenant" agreements (such as non-compete agreements, non-solicitation agreements, and non-disclosure agreements) to protect their confidential information, customer relationships, trade secrets or other intellectual property, and to otherwise prevent unfair competition. This article will review many of the common mistakes employers make which could impact their agreements' enforceability and result in costly losses to the employer.

Many may also be aware that in July, President Biden signed Executive Order 14036 directing more than a dozen federal agencies to implement action on 72 initiatives designed "to increase competition and limit the power of corporations." According to the White House "Fact Sheet" accompanying the Order, one of those initiatives requires the Federal Trade Commission ("FTC") to take steps "to make it easier [for employees] to change jobs and help raise wages by banning or limiting non-compete agreements." This is a clear departure from how non-competition agreements have been analyzed before now, since there is currently no federal law governing non-compete agreements. Instead, their enforceability has been a matter of state law. With this Executive Order, the Biden administration seeks to limit enforceability of non-competition agreements by federal rule. While any such rule-making by the FTC is likely to be met with litigation from business groups challenging the scope and jurisdictional basis for the rules, it will create complications and risks for employers while such litigation is pending.

While we do not expect to see a formal proposed rule from the FTC for several months—and speculation abounds regarding what that rule might contain—employers should take this time to review the restrictive covenant agreements they ask their job applicants and/or existing employees to sign. Even under existing law, many employers often over-reach when drafting those agreements

PROFESSIONALS

Laurie E. Meyer
Partner

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or make other mistakes that make them unenforceable.

1. The Employer Asks All of its Employees to Sign Non-Compete Agreements. Many employers ask every one of their employees to sign non-compete or non-solicitation agreements as a normal onboarding event—even their low-wage employees whose departure from the employer would not pose an unfair competition risk to it. By doing so, those employers inadvertently cause their non-compete and non-solicitation covenants with key employees to be invalid. Years ago, for example, presumably in an effort to retain their workers in a tight labor market, some franchisees of a national sandwich chain famously asked their entry-level, low-wage sandwich makers to sign non-compete agreements that prevented them from working for other sandwich shops within a three-mile radius for two years after leaving the company. Those agreements were deemed unenforceable for an important reason: the sandwich makers had no specialized skill, no access to confidential company information, no close customer or client relationships or the like that would justify the agreements.

It is important to recognize that, well before delving into the enforceability of the particular terms of the agreement (discussed below), a court will first consider whether the agreement is **"reasonably necessary for the protection of the employer or principal."** As far back as 1959, a Wisconsin court observed that "an employer is not entitled to be protected against legitimate and ordinary competition of the type that a stranger could give." Nonetheless, Wisconsin courts have consistently recognized that employers do have a legitimate business interest in protecting their truly confidential proprietary information, customer relationships, the specialized training or skill they provide to employees, and the like. Consequently, employers should never use a "one size fits all" approach to its employees and non-compete agreements, but should carefully consider whether preventing the post-termination activity of each individual would serve a legitimate business interest.

2. Lack of Consideration. One of the most common mistakes that employers make is failing to provide legal "consideration" to the employee in exchange for their signing a non-compete agreement or other restrictive covenant. Legal consideration is a necessary component to any enforceable legal contract and, in broad terms can be described as something of value to which the employee is not already legally entitled. When an employer asks an existing employee, for example, to sign a non-compete agreement without providing anything of value in return, the enforceability of the agreement can be challenged on lack-of-consideration grounds. Under current Wisconsin law, that consideration can include an offer of employment, a discretionary (as opposed to promised) bonus, a promotion, and the like. In the case of an existing employee, continued employment may constitute adequate consideration, but only if the employer makes it clear that the existing employee's continued employment with the employer is conditioned upon him or her signing the agreement. Importantly, as mentioned earlier, given that currently non-compete enforceability is a matter of state law, this may not be true in every state. For instance, in Illinois, beginning in

January, agreements must offer employees at least two-years of at-will employment after they sign the agreement; if the employer terminates that employee prior to the two-year mark, the agreement may not be enforceable.

3. Length of Restricted Period is Too Long. The general rule with regard to the duration of any restricted period is that it should be no longer than necessary to protect the employer's legitimate business interests. In Wisconsin, non-compete and other restrictive covenants in connection with employment (as opposed to the sale of a business) that limit competitive activity for more than **two years** are virtually always deemed unenforceable, since they are considered an unreasonable restraint on trade. Employers should carefully consider just how long the restriction is truly necessary.

4. Scope of Restricted Territory is Too Broad. Under Wisconsin law, territorial limitation, when it comes to restrictive covenants, can be stated in terms of a **geographic limitation** (e.g., a ten-mile radius), by **customer-list limitation** (e.g., a non-solicitation provision that prevents direct contact with the employer's customers *that the employee had contact with* during the immediate months prior to their departure (the "look back period") for a period of time after departure), or even by a **specific list of activities** that the employee has performed for the employer during the look back period. When a geographic limitation is used but is necessarily broad in scope (e.g., North America, the world), or where geographic location is not as relevant (e.g., where the employee contacts customers all over the world via the internet), it is all the more crucial to make the scope of prohibited activity as narrow as possible (e.g., by narrow, specified industry).

When an employer includes a territorial limitation that goes beyond where the employer actually does business or the scope of its business, it risks the enforceability of its non-compete provision. A court is likely to find that such an over-reach impermissibly prevents the employee from earning a living in a way that does not protect the employer's legitimate interests. Similarly, if an employer uses a non-solicitation clause to restrict a former employee's ability to contact *any* of its customers—even those the employee never met or did not engage with recently—a court may strike the agreement as overbroad.

5. Failure to Ascertain Whether New-Hires Have Existing Non-Compete Agreements with Previous Employers. Many employers unwisely believe they have no liability if they hire an employee with an existing restrictive covenant with their previous employer, thinking that the breach would be the employee's problem. Those employers may be surprised when the previous employer sues them, most often under "tortious interference with contract" or conspiracy grounds. Employers should always ask applicants if they have any existing agreements that would prevent them from taking and performing the position in question—and document the applicant's answer. If the answer is "yes," the employer should get a copy of the agreement and obtain a legal opinion as to both its applicability and enforceability before hiring the individual.

6. Failure to Include an Assignability Clause. Some jurisdictions do not permit the seller of a business to "assign" or transfer its non-compete or other restrictive covenants to a buyer of the business unless the employee has consented to the assignment. Failure to include such a provision could result in an unpleasant surprise to both parties to such a transaction if they find that the non-compete agreement ceases to exist as soon as the seller terminates the employment relationship.

7. Failure to Continually Review Existing Agreements with Counsel. The law regarding the enforceability of non-compete agreements is continually modified or narrowed by changes to applicable statutes and by appellate courts interpreting certain provisions' enforceability. And—as we are seeing now with moves by the Biden administration—they may be soon subject to further limits. Employers should regularly review their existing non-compete and other agreements with experienced counsel to ensure that a previously drafted agreement remains enforceable under current law or when undertaking due diligence in a business purchase or preparing a company for sale.