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Making Noncompete Agreements Work for Employers

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I participated in a recent conference of labor lawyers who were asked the following question: What advice can you give to employers to make noncompete agreements work for them in keeping employees and their knowledge on board? A terrific and timely question, and my response follows.

The three most important things for any employer to understand about noncompete agreements are: (1) the difference between when they're truly needed and when they're not; (2) how to draft them to maximize real utility; and (3) their practical limitations as tools of employee retention.

Noncompetes: Needed or Not?

Noncompete agreements are needed to keep from competitors three types of key employees: scientists who know your company's secret sauce, executives who know confidential business information of strategic value, and sales representatives in a position to divert customer accounts to rivals. Attempts to impose noncompete agreements more broadly will prove ineffective and self-destructive. Such attempts impair recruitment (raising the cost of hiring infrastructure employees who will need to bargain against the risk they may one day be excluded from their chosen field); they are not apt to produce agreements courts will actually enforce (because no ''legitimate business interest'' is implicated); and they contribute to a culture of disrespect for the company's restrictive covenants (because employers will typically opt not to enforce noncompete agreements against many categories of employees who have been required to sign them, and well-advised competitors will not be deterred from hiring in the face of noncompetes that cannot be effectively defended).

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A culture of disrespect for the noncompetes will breed more challenges by departing employees, while at the same time increase the likelihood of judicial hostility to such agreements that become the subject of legal action. In short, a judicious discrimination between employees who do and do not need to be subject to noncompetes will pay valuable dividends.

Maximizing Utility

Any decent lawyer can draft a noncompete that meets the requirements of reasonableness in respect to subject matter, duration, and geographic scope. The most useful noncompete covenants, however, are the ones that provide the greatest and most easily accessed remedies. The right to plead a judge for an injunction against the competitive employment (the canonical remedy in the modern noncompete) is fine.

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But that takes time and money, and a court may still not choose to grant you one.

Equitable remedies are highly discretionary, and courts have a time-tested hostility to restrictive covenants in general. More effective are noncompetes that can be enforced through unilateral employer action (such as through cancellation of stock options or restricted equity, termination of severance payments, and the like). These are remedies that employers can implement on their own initiative, at no cost, and with only a modest risk that an employee might elect to initiate a lawsuit to challenge the clawback. The availability of such remedies will dramatically change the leverage equation in the employer's favor, and thus enhance the deterrence value of the noncompete.

Other frequently overlooked remedies in noncompete agreements are tolling provisions (providing that an employee will always be held responsible for complying with the full durational term of the noncompete, regardless of how long it takes for enforcement to occur), liquidated damages (prescribing fixed financial consequences, otherwise difficult to prove in this type of litigation, in the event of breach), forfeiture of prior compensation and/or gain-share (i.e., the disgorgement of economics specifically conferred on the employee in consideration of the noncompete), and attorneys' fee-shifting (providing that an employee found to have breached the noncompete must pay the former employer's enforcement-related attorneys' fees). These sorts of economic remedies, particularly in combination, will materially strengthen the deterrent effect of a noncompete.

An injunction against competition will naturally remain the preferred remedy for employers confronted by an employee's breach, but the best remedy of all is for your competitor not to hire the employee in the first place. The risk of a disabling injunction, unaccompanied by other economic risks, provides scant deterrence to the competitor who covets your employee. After all, if the only

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penalty for robbing a bank were the requirement to give back the money, many would choose to rob banks for a living. This is the paradigm presented when a noncompete exposes the successor employer to no more than the risk that a court might make it give up the breaching employee it hired.

A smartly drafted noncompete is also one that anticipates (and extinguishes) the most frequently raised defenses to enforcement. For example, some noncompetes simply prohibit ''competition'' against the employer, without defining what does and does not qualify as impermissible competition. This sort of drafting invites breaching employees to exploit the ambiguity as to who is and is not a ''competitor.''

The effectively drafted noncompete is one that eliminates this ambiguity by defining prohibited competition with specificity (and perhaps including, without limitation, particular competitors by name).

Another frequently raised defense, made famous in the *AFC Cable* [1] and *Lycos* [2] decisions, is that intervening changes in the employee's job duties and/or compensation operated to terminate the employment agreement that included the noncompete, and replace it with an agreement lacking one.

An effective noncompete will defeat this argument in its text, by providing that no changes in the employee's title, duties, or remuneration will operate to cancel his/her covenant not to compete or require that such covenant be re-executed in a new agreement.

Finally, employees looking to evade enforcement of a noncompete frequently argue that the employer itself materially breached the contract, thereby relieving the employee of any obligation to honor its restrictive covenants. Drafters of noncompetes do well to anticipate this defense with negating language such as the following: ''No claimed breach of this Agreement by the Company, or any purported violation of law, shall excuse the Employee from his obligation to perform his commitments under Sections ___ hereof.''

In short, the best noncompete is one that can be successfully enforced; and that means drafting them to close the most commonly claimed loopholes.

Limitations as a Tool of Retention

Employers who think that yoking employees to their organization through onerous noncompete terms is the key to retaining such talent are sadly mistaken. Noncompetes close off just one exit on this highway; and even that one can be traversed by an employee/competitor prepared to pay a large enough toll.

Inducing retention through positive experience and incentives in the workplace, economic and otherwise, proves time and again to be the most effective tool for employee retention. The best strategy for talent retention is the one that motivates an employee with rewards if he stays, not the one that threatens him with legal risks if he leaves.

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[1] AFC Cable Systems Inc. v. Clisham, 62 F. Supp. 2d 167 (D. Mass. 1999).

[2] Lycos Inc. v. Lincoln Jackson, 18 Mass. L. Rep. 256 (Mass. Super. Ct. 2004).

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