Non-Competition Agreements

By Raymond P. Kolak

I see more confusion and flat wrong thinking about non-competition agreements than any other area of business law. Ann wants to hire a new person in sales for her materials business. "She has no experience in our business, and I'm going to teach her how to sell and introduce her to our customers. I won't teach her the business, then let her march our customers over to our competitor for more money. Write me a contract that prevents her from working for my competitors for at least five or ten years."

Or John tells me he is hiring a plant manager, and is issuing a small amount of stock to him. I suggest getting a non-competition agreement, but John says, "Why bother? Those things are never upheld anyway, are they? It would just sour the beginning of the relationship, and not be of any benefit to us."

Who is right? Neither. Non-competition agreements can be useful tools for a growing business if structured properly and not overreaching. This is an area of law in which you are rewarded for asking for only what you need, not what you want.

Non-competition agreements fill a void because employment agreements alone are difficult to enforce in the United States.

Let's say that you sign up an employee under an employment agreement for ten years, and the employee quits on you after six months. What can you do to enforce the contract? Well, you can't get a court order requiring the employee to work for you. Enforced servitude by an employee is prohibited in all states. Technically, you can get a court to award you money damages, measured by the cost of a replacement employee, less the compensation you were paying to the employee who quit. Assuming you can find a replacement employee who will accept the same salary, you will have no damages. Even if the replacement employee gets more, the salary increase may not be big enough to warrant hiring a lawyer and chasing down the employee who quit.

A non-competition agreement (sometimes called a covenant not to compete) allows you to do something to enforce the employment relationship. A non-competition agreement is an agreement, usually between an employer and employee, in which the employee agrees not to compete with the employer after leaving employment. For example, Ann's non-competition agreement might state that if her new sales person leaves employment, he will not call on any of Ann's customers in her state and the surrounding states for a period of 6 months, for the purpose of soliciting orders for a competing materials business. This is just one example of a non-competition agreement; there are many patterns and permutations that can be used.

Judges don't like to enforce non-competition agreements because they can take away a person's ability to earn a living. In legal parlance, they are "strictly construed"

against the employer, meaning that every question of interpretation is slanted to the employee's side, and sometimes, the agreements are thrown out altogether.

In many states, the courts will first ask whether the employer has a "protectible interest" to be preserved by the non-competition agreement. Often, this protectible interest is the relationship with customers, if that relationship has to be built over time and is near permanent. A seller of big-ticket industrial machinery to automobile manufacturers probably has a protectible interest, while a telemarketer for replacement windows does not.

The non-competition agreement should have time, geographical, and activity limitations to be enforceable. Choose a time period which will allow you to find and train a replacement employee, and to re-establish the relationship between the customers and the new employee. That period could run from a few months to several years, depending on the industry and the product. Choose a geographical limitation that corresponds to your actual sales area, or the area which you can reasonably aspire to. That can range from a radius of a few miles to the entire globe. Finally, name the activities you want to prohibit. For the sales force, this would be soliciting customers for a competitor, and for other positions might prohibit working in any capacity for a competitor.

Courts treat non-competition agreements for your shareholders differently than agreements for mere employees. A non-competition agreement for a shareholder or shareholder-employee is more likely to be enforced. You can use longer time periods for shareholders, and can sometimes prohibit working for a competitor completely. The theory is that since the shareholder received something from the corporation (the shares of stock), it is fair to ask the shareholder to give up something in terms of competing with the corporation. On this point, some courts will not enforce a non-competition agreement against a mere employee unless the employee gets something extra for it. For new employees, this can be the initial job offer itself, and for existing employees, this can be a raise, bonus, or promotion.

Your should tailor your non-competition agreement to protect what you need to protect, but go no further. Some state law automatically trims out provisions that are overbroad, while preserving the rest of the agreement, but other states will throw out the entire non-competition agreement if any clause is invalid. For example, let's say that you hire a new sales engineer for your landscaping business, and have him sign a non-competition agreement with a time limitation of 6 months, appropriate activity limitations, and a geographical limitation consisting of a 75 mile radius. The only problem is that you have never sold a customer outside of 35 miles, and travel costs make it uneconomical for you to do so. Some courts would throw your entire agreement out, meaning that your former sales engineer could start competing with you for your current customers on his first day of work for your competitor.

One word on trade secrets and confidential information. While courts are hard on employers seeking to enforce non-competition agreements, you will have a much easier

time protecting your trade secrets and confidential information. A trade secret is any kind of information that has economic value, which is not generally known, and which you protect through reasonable efforts to maintain its secrecy or confidentiality. A trade secret can consist of a customer list, manufacturing process, or product formula. You can prohibit your employees from disclosing trade secrets forever, with a proper non-disclosure agreement. Sometimes, non-competition agreements and non-disclosure agreements are combined in the same agreement, but if you have any doubt about the enforceability of your non-competition agreement, it is better to keep them separate.

In making the legal judgment on whether a non-competition agreement is enforceable or not, I like to put myself in the position of the employee. Does the employee have any reasonable choices to continue to make a living after leaving you? A court will ask the same question, so you should do so before the document is signed.

Let's take Ann's employee, who has agreed that if he leaves employment, he will not call on any of Ann's customers in her state and the surrounding states for a period of 6 months, for the purpose of soliciting orders for a competing materials business. How can he make a living after leaving Ann?

Well, if he can wait 6 months, he can call on any of Ann's customers in her state and the surrounding states, for the purpose of soliciting orders for a competitor. If he can't wait 6 months, he can call on any of Ann's customers *outside* her state and the surrounding states, for the purpose of soliciting orders for a competitor. Or, he can call on any of Ann's customers in her state and the surrounding states, for the purpose of soliciting orders for another industry, such as office supplies.

Since the employee has alternatives, Ann should be able to convince a judge that her non-competition agreement is reasonable. If the employee is new to the industry, I like to attach a copy of the employee's resume to the non-competition agreement, to show that the employee was able to make a living outside the client's industry, prior to beginning work.

Don't have your attorney go overboard in writing these things, but don't dismiss them entirely either. Moderation and good judgment will be rewarded here.

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