Overreaching Covenants Not to Compete Under Attack from All Sides

By John Vering and Jamie Maggard

In the past few years, executive, legislative, and judicial branches in several jurisdictions have taken action to prevent employers from using overly broad non-compete agreements.

The well-known general rule is that a covenant not to compete is only enforceable if its terms are reasonable and necessary to protect the legitimate business interests of the employer. *See e.g., Medix Staffing Solutions, Inc. v. Dumrauf*, No. 17C6648, 2018 WL 1859039 (N.D. Ill. April 17, 2018). Courts then often engage in an analysis of the business interests involved and the geographic and temporal scopes of such agreements. Despite the familiarity with these standards, the analysis of whether a non-compete agreement is enforceable has long been unpredictable due to the many vagaries of state law, the fact-intensive nature of a court's review, and the proclivities of the judge you happen to draw. *See e.g.* Steven Kayman & Lauren Davis, *A Call for Nationwide Consistency on Noncompetes* (Law360 Employment, November 27, 2018).

Traditionally, covenants not to compete were designed to prevent unfair competition and were confined to corporate executives, persons with knowledge of trade secrets, sales persons and client-based professionals (e.g., physicians and accountants). However, non-compete arrangements have recently become much more common in many other types of employment, especially in the service industry, with their reach extending to chefs, yoga instructors, fast food employees, editorial employees, phlebotomists, student interns and a wide range of low income workers with no knowledge of trade secrets and no effective ability to entice a customer to leave the former employer.

Executive – Attorneys Generals settle with WeWork, Jimmy John's, Law360, EMSI and Reliance Star Payment Services, Inc.

The New York Attorney General's office has been aggressive in pursuing and obtaining settlements restricting employers from using overbroad noncompete agreements. A prime example is a recent settlement with WeWork, a company that provides a network of shared spaces for rent and associated services to clients throughout the United States and internationally. The company used non-compete agreements with almost all of its 3,300 employees in the United States. The WeWork settlement agreement prevented employees – including janitors, baristas, and executive assistants – from working for competitors after leaving the company regardless of job duties, knowledge of confidential information, or compensation, and the agreement applied to all levels of employees. NY Attorney General Press Release (September 18, 2018);Yuki Noguchi, *Under Pressure, WeWork Backs Down on Employee*

Noncompete Requirements, National Public Radio (September 18, 2018).

The respective Attorneys General for New York and Illinois began separate but concurrent investigations into WeWork's use of non-compete agreements. After the settlement, the non-compete agreements will only remain intact for 100 executive level employees. For 1,400 U.S. employees, the agreement was fully released, and another 1,800 received significant modifications to their agreements, including reduced terms, smaller geographic areas, and a more narrowly-defined scope of competition. *Supra* Noguchi, *Under Pressure, WeWork Backs Down on Employee Noncompete Requirements*. The New York Attorney General has also reached settlements restricting the use of overbroad noncompete agreements with Jimmy John's, Law360, EMSI and Reliance Star Payment Services, Inc. *See* New York Attorney General Press Releases of September 18, 2018 and October 26, 2018.

Legislative – Massachusetts legislature restricts non-compete agreements

In August 2018, the governor of Massachusetts signed a bill into law that aims to prevent the overuse of noncompete agreements. The law, which applies to agreements entered into on and after October 1, 2018, restricts the use of non-compete agreements by:

- Banning such agreements made with employees who are 1) non-exempt under the FLSA, 2) under the age of 18; and 3) part-time college or graduate students;
- Requiring that non-competes be limited to 12 months (with a few exceptions), be presented to new hires with an offer letter or within 10 days of the start date, and be signed by both the employee and employer;
- Requiring that any agreements entered into after the commencement of employment be supported by "fair and reasonable consideration independent from the continuation of employment";
- Invalidating any non-compete agreement with an employee who was laid-off or fired without cause;
- Requiring a "garden leave" clause in non-compete agreements unless there is "other mutually agreed upon consideration;" and
- Specifying that in most cases, a suit to enforce or challenge a noncompete agreement must be brought in the county where the employee resides.

Mass. Gen. Laws Ann. 149 § 24L. The most unique feature of this law is the "garden leave" requirement, which mandates that employers agree to pay the employee 50% of his/her highest salary in the two years preceding termination for the period in which the employee is prevented from working due to the non-compete agreement. This clause is subject to an exception if there is "other mutually agreed upon consideration," which is not defined. § 24L(b)(vii).

Legislative – California Restricts Choice of Law and Choice of Forum Clauses

California has long been hostile to non-compete agreements. Recently, as an additional protection for workers, Governor Brown signed into law California Labor Code Section 925 (effective for contracts entered into or modified or extended after January 1, 2017) which generally provides that unless the employee is represented by legal counsel in negotiating the agreement, an employer cannot require an employee who primarily resides and works in California, as a condition of employment, to agree to a provision that would (a) require the employee to adjudicate outside California a claim arising in California or (b) deprive the employee of substantive protection of California law with respect to a controversy arising in California. If an employer seeks to enforce a choice of law or choice of forum clause contrary to Section 925, the employee can seek injunctive relief and other remedies including reasonable attorney's fees.

Judicial – Illinois Federal court rejects non-compete agreement that is too broad on its face

In April of 2018, the Northern District of Illinois examined a covenant not-to-compete agreement and granted the employee's motion to dismiss the employer's suit to enforce it. *Medix,* 2018 WL 1859039. The Court found the agreement was too broad because it barred the employee from being employed in any capacity (including janitor) by any company that works in the same business as the employer within 50 miles of its office, whether the company is actually a competitor or not. *Medix*, 2018 WL 1859039 at *3.

The *Medix* court is not alone as other courts have also rejected non-compete agreements that were overly broad on their face. *See e.g. Medispec, LTD v. Chouinard*, 133 F. Supp. 3d 771 (D. Md. 2015) (finding a covenant not to compete overly broad by attempting to prevent former employee from obtaining employment in any capacity (including jobs unrelated to sales) for any other medical device company even though he only sold one type of device for his former employer). Similarly, in *JAK Productions, Inc. v. Bayer*, 94 F. Supp. 3d 777 (S.D. W. Va. 2015), the court found a covenant not to compete unreasonable on its face because the 30-mile geographic limitation was not tied to any business-related purpose in its call center business because calls could be made from anywhere.

Although courts in many states will blue pencil or strike overbroad non-compete provisions, a court in equity can decide in its discretion not to use its equitable power to reform an overbroad agreement but may simply refuse to enforce the agreement and may deny or substantially reduce attorney's fees to the employer who seeks to enforce an overbroad non-compete agreement. See e.g., *H&R Block v. Lovelace*, 493 P.2d 205 (Kan. 1972) (refusing any relief where covenant lacked any territorial limits); *Payroll Advance, Inc. v. Yates*, 270 S.W.3d 428, 436 (Mo. App. 2008) (refusing to enforce any part of an overbroad non-compete agreement that prevented pay day loan employee from working for any lender within 50 miles of any of employer's seventeen branch offices).

Important Points to Keep in Mind:

- Be aware of the national trend of attacks on overly-broad agreements. Consider drafting narrow non-compete agreements that prohibit only "unfair and unreasonable competition" and do not unreasonably restrict the nature of the job a former employee can take. Consider whether using only non-solicit and non-disclosure agreements will meet your client's needs. Remember that agreements with low wage employees or employees who do not have access to trade secrets or the ability to move customers to a competitor will be scrutinized.
- Seek only the relief that you need to protect your client's legitimate business interests such as preventing solicitation of customers and employees and disclosure and use of confidential information and trade secrets.
- If you are defending against an overbroad non-compete agreement, argue that it is so unreasonable that it should not be narrowed but rather the action should be dismissed and/or that attorneys' fees should be denied because the employer's counsel did not prevail on all parts of the overbroad non-compete agreement.

This article is general in nature and does not constitute legal advice. Readers with legal questions should consult the authors John Vering or Jamie Maggard or Rachel Baker, John Neyens or Brenda Hamilton or your regular contact at Seigfreid Bingham at 816-421-4460.