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#NON-COMPETES: A PR CRISIS? A PRACTICAL GUIDE TO CRAFTING REASONABLE NON-COMPETE AGREEMENTS IN LIGHT OF RECENT LEGAL DEVELOPMENTS¹

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INTRODUCTION

Non-compete agreements continue to face a steady attack from a variety of camps within the business, legal, political and academic communities. Those arguing against the use of restrictive covenant agreements typically rely on the premise that restrictive agreements prevent individuals from earning a livelihood, trap employees in positions with little bargaining power, and prevent innovation and economic development to flourish. Another more recent argument being raised against non-compete agreements is that they “lower wages” by limiting employee mobility. While that argument has been made, not once have we found any statistical or other support for that claim. Nonetheless, these positions all fail to consider the value in *reasonable* restrictive agreements, including protecting the entrepreneur who invests significant resources into developing ideas, and ignore other positive impacts that non-compete agreements provide.

Unfortunately, the degree of recent criticism directed at non-compete agreements has heightened in light of sensational cases that showcase the negative aspects of *unreasonable* non-compete provisions. In an effort to prevent even the slightest damage to any potential competitive business interest, over-zealous employers will often draft non-compete provisions that are so broad that they simply fail to serve what should be their focused and narrow purpose. The following recent headlines cast a black eye on restrictive covenants:

- “These days, even janitors are being required to sign non-compete clauses.” USA Today, May 27, 2017, Sophie Quinton, Pew/Stateline. <https://www.usatoday.com/story/money/2017/05/27/noncompete-clauses-jobs-workplace/348384001/>
- “Jimmy John’s Makes Low-Wage Workers Sign ‘Oppressive’ Noncompete Agreements. Huffington Post, October 13, 2014, Dave Jamieson. http://www.huffingtonpost.com/2014/10/13/jimmy-johns-non-compete_n_5978180.html
- “How Noncompete Clauses Keep Workers Locked In.” NYTimes, Conor Dougherty, May 13, 2017. <https://www.nytimes.com/2017/05/13/business/noncompete-clauses.html>

Apart from drawing bad press, the reality is that these poorly drafted or inappropriately applied provisions are rarely enforced because courts will only enforce reasonable restrictions that actually protect a legitimate business interest. In fact, *reasonable* non-compete agreements, along with other types of restrictive covenants when applied to the correct categories of employees, promote and cultivate innovation and serve a vital role in a knowledge-based economy by protecting entrepreneurs’ ideas, investments, goodwill and other legitimate business interests. The negative attention focused on non-compete agreements, though, often overshadows these positive impacts and leads to overreaction,

¹ This article is an update of a previous publication by the authors. In light of the uptick in efforts to ban or limit restrictive agreements in other states, the authors believe an update is warranted.

including the demand for legislatures to limit or entirely ban non-compete agreements. In this article, we take a closer look at examples of the types of extreme cases that have stirred debate about non-competes, and we will demonstrate how employers in each of those situations could have been more reasonable in drafting or application to avoid not just the bad press, but also to avoid the risk of a restrictive agreement not being enforced.

A. Non-Competes Can Be Enforceable So Long As They Are Reasonable

There is a common misperception that non-compete agreements completely bar individuals from earning a livelihood. That simply is not true. In order to be enforceable, a non-compete agreement must be reasonably tailored as to its duration, geography, and scope of activity restricted and also protect the legitimate business interests of the party seeking its enforcement. See e.g. *Rehmann, Robson & Co v. McMahan*, 187 Mich.App. 36, 46; 466 N.W.2d 325 (1991); *Lowry Computer Products, Inc. v. Head*, 984 F.Supp. 1111, 1113 (E.D. Mich. 1997). To the extent a non-compete agreement is deemed unreasonable, a court will not enforce it.

B. Controversy Sparked! Three Examples of Companies Seeking to Enforce Unreasonable Non-Competes

1. *Jimmy John's Gets Freaky Greedy*

One of the leading cases to spark the fire against restrictive covenants involved sandwich shop Jimmy John's use of an overly broad, two year non-competition agreement for its sandwich makers and delivery personnel. Jimmy John's required virtually every employee to sign a form non-competition agreement that restricted him or her from working for another business earning more than 10 percent of its revenue from sandwich making within three miles of any Jimmy John's location. While Jimmy John's apparently never sought to enforce the non-competition agreement against its low level employees, the States of New York and Illinois brought legal action against the company to protect against restraints of trade, that is, the purported lowering of wages these agreements created. Jimmy John's has discontinued the use of the non-competition agreement in those particular states.

2. *How Jimmy John's Could Have Avoided a PR Disaster and Still Protected its Legitimate Business Interests*

The Jimmy John's example is not representative of how to best protect a company's legitimate business interests. Jimmy John's was simply wrong in using this type of restrictive agreement with its lower level employees. The attempt was a mistake on many levels, including using the same type of restrictive agreement for every level of employee. In the case of restrictive covenants, one size does not fit all. In drafting non-competition and other restrictive agreements, employers must consider what they are trying to protect and how certain employees could potentially harm the company's competitive interests. Those factors should be used in tailoring the restrictive covenants to be reasonable for each position. The Jimmy John's regional managers, for example, likely have access to different levels of information than the delivery drivers. The different restrictive covenants that each is required to sign should reflect that. The company has different competitive interests to protect with regard to each employee. Jimmy John's was not reasonable to require its delivery drivers to sign the same restrictive covenant as its high level executives. Realistically, if Jimmy John's wanted to protect itself, a confidentiality or non-disclosure agreement as to these lower level employees would have sufficed. Had it used such an agreement instead, Jimmy John's likely would not have met any criticism, much less government investigation. Our view is one supported by the practical reality involving enforcement of non-compete agreements - those that are reasonably tailored in duration, geography, and scope do not completely restrain an employee's ability to earn a livelihood.

3. *A Swim School Swims in Greedy Waters*

A recent Michigan case is another example of how a court will punish a greedy employer that improperly applies restrictions to low wage workers. In *Goldfish Swim School v. Aqua Tots*², a swim school used a non-competition agreement to restrict its former minimum-wage employee from working for a competitor swim school within a 20-mile radius of any Goldfish location for a period of one year. The agreement also prohibited former employees from soliciting Goldfish employees or customers for an 18-month period. Goldfish argued that the non-compete agreement was in place to protect its swimming instructional manual, its customer list, and its swimming strokes, which are of a proprietary nature. However, the evidence showed that the hiring competitor specifically precluded the swim instructor from using any methods that he learned at the Goldfish school and had its own methods and practices on instruction. In fact, the methods taught were in plain sight in that parents and the general public could see those techniques in action by simply attending a lesson. Furthermore, Goldfish could not point to a single customer that left its school to follow the swim instructor. Lastly, the swim instructor had a great deal of experience aside from his training at Goldfish. Considering all of these factors, the Court determined that the restriction did not protect any legitimate business interest and refused to enforce it.

4. *How the Swim School Could Have Avoided a PR Disaster and Still Protected its Legitimate Business Interests*

The Court's determination does not mean that Goldfish does not have legitimate business interests to protect. Indeed, its customer lists and proprietary information are essential elements of the company's business model. Goldfish likely expended great resources into developing its clientele and its unique swimming methods. Assuredly, if employees could freely take Goldfish's truly proprietary information to a competitor, the company's future could be in jeopardy. However, in being overly zealous in its application and enforcement of a restrictive covenant, Goldfish did not protect any of its interests in the end. Had Goldfish drafted the restriction more narrowly, it may have had better luck. For example, rather than preventing the swim instructor from working with any competitor, Goldfish may have been better off narrowly tailoring the restriction to only prevent him from working with Goldfish customers he worked with while at Goldfish. This narrower provision would protect the employer's business interests, while allowing the employee to move freely in an open market. Alternatively, the use of a non-solicit agreement alone to prevent the former employee from contacting or working with or for any Goldfish customers would have sufficed. It would have been just as effective and more likely to be enforced.

5. *Amazon Enters the Greedy Jungle*

The final example of greedy employers includes two of the most innovative companies of the twenty-first century – Amazon and Google. In 2013, Amazon filed suit against a former executive who went to work for Google several months after he was fired from the company³. The agreement that Amazon sought to enforce included confidentiality provisions, a ban on the employee doing business with any of Amazon's customers or prospective customers for 18 months, a ban on working in any capacity for any company that competes with Amazon, and a ban on hiring or employing any former Amazon employee. Amazon certainly covered all of its basis with this agreement – or at least, it thought it did. However, as we have repeatedly said, when employers are overly greedy with restrictive covenants, courts will routinely determine that they are unreasonable. In response to Amazon's preliminary injunction motion, the Court only enforced the part of the contract that restricted the former employee from working with Amazon's business customers, and the Court limited the non-solicitation clause to only three and a half months.

2 BHB Investment Holdings, L.L.C., d/b/a Goldfish Swim School of Farmington Hills v Steven Ogg and Aqua tots Canton, L.L.C. Case No. 330045 (Mich. App. Feb. 21, 2017).

3 Amazon.com, Inc. v. Powers, Case No. 12-1911 (W.D. Wash.)

6. How Amazon Could Have Avoided a PR Disaster and Still Protected its Legitimate Business Interests

In many ways, Amazon was actually lucky. The court took it upon itself to essentially re-write Amazon's agreement to make it enforceable. Many courts, although they may have the right to do so under state law or the provisions of the agreement itself, will refuse to re-write a contract or revise a contract if it is unreasonable on its face. As such, companies are better off narrowly tailoring and making their agreements reasonable at the outset and not expect that a court will do it for them. In drafting these provisions, employers should consider how long the information that the employee had access to will be sensitive. See *Amazon.com, Inc. v. Powers*, Case No. 12-1911 ("Amazon has not explained why it selected an 18-month period, nor has it disputed [the former employee's] suggestion that the Agreement he signed is a 'form' agreement that Amazon requires virtually every employee to sign. Because Amazon makes no effort to tailor the duration of its competitive restriction to individual employees, the court is not inclined to defer to its one-size-fits-all contractual choices.").

C. A Legislative Update: Non-Compete Controversy Sparks Action in Some States

The attacks on restrictive covenants are often coupled with calls on state legislatures to ban or drastically limit enforcement of restrictive covenant agreements. Nearly every state honors some form of restrictive covenant (e.g., non-compete, non-solicit, anti-piracy, etc.) so long as the restriction is reasonable as to its duration, geography, and scope of activity. However, just as every rule has its exceptions, so too does state enforcement of non-compete agreements – California, North Dakota, and Oklahoma generally prohibit non-compete agreements. See Cal. Bus. & Prof. Code § 16600 (West 1941); N.D. Cent. Code § 9-08-06 (1943); and Okla. Stat. tit. 15, §§ 217-219a. Currently, the push for legislators to ban or severely limit non-compete agreements, as proposed in Massachusetts and Nevada, has been inspired by extreme cases like those discussed above where greedy employers just go too far.

For years, Massachusetts has entertained the idea of banning or greatly limiting non-compete agreements, largely based on the premise that it needs to be more like California to attract and retain talent and innovation. Most recently, in January of 2017, Senate Bill 1020 entitled "An Act to Protect Trade Secrets and Eliminate Non-Compete Agreements," was proposed in the Massachusetts Senate. If enacted, the proposed legislation would render non-compete agreements in employment contracts void and unenforceable. The bill was referred to the Joint Committee on Labor and Workforce Development on January 23, 2017. There are currently four other bills in the Massachusetts legislature that seek to restrict rather than void non-compete agreements with proposals that include limiting the temporal scope of non-compete agreements, prohibiting non-compete agreements against certain categories of workers, including non-exempt employees, students, employees terminated without cause, and employees 18 years or younger, and requiring non-competes to be supported by consideration independent from the continuation of employment.⁴

Nevada has followed suit and is currently considering a bill that would void non-compete provisions that prohibit employees from seeking employment with or becoming employed by a competitor for a period of more than three months after the employee's termination. That, of course, is an extremely short duration in the non-compete realm. On the other end of the spectrum, efforts in Michigan to ban non-competes garnered no significant support and have all but died. Interestingly, Georgia moved in the other direction when it took steps toward broadening the scope of non-competes. In 2010, the Georgia electorate approved a Constitutional amendment that made it easier to enforce non-compete agreements. One year later, the Georgia legislature passed a new restrictive covenant statute, which, for the first time, allowed Georgia courts in reviewing non-competition agreements between employer and employee to blue-pencil or modify restrictive covenants to be reasonable.⁵ The act substantially liberalizes drafting requirements for restrictive covenants in Georgia by permitting courts to partially enforce overbroad restrictive covenants. As a result, Georgia has become one of the most favorable jurisdictions for enforcement of restrictive covenants in employment agreements.

4 (HB 1017, SB 840, HB 2366, and SB 998)

5 O.C.G.A. § 13-8-53(d).

Some states have recently enacted legislation to ban non-compete agreements between employers and low wage workers. Illinois banned the use of non-compete clauses for workers making less than the greater of the hourly minimum wage under federal, state, or local law or \$13.00 per hour starting January 1, 2017.⁶ Similar legislation has been proposed in Maryland,⁷ Massachusetts,⁸ and Maine.⁹ In Maine, the bill passed in the House of Representatives, but it failed to pass the Senate by only three votes. The bills in Maryland and Massachusetts are still pending. Additionally, New York Attorney General Eric Schneiderman has announced his plans to introduce legislation this year that would prohibit the use of non-competes for any employee earning less than \$900 per week.¹⁰

The State of Washington (ironically, the home of Amazon) has recently considered banning or restricting the use of non-compete provisions. As its model, Washington has often looked to California, a state that currently bans non-compete agreements all together, except in very limited circumstances (i.e., the sale of a business). Since January 2015, Washington has considered at least three bills to restrict non-compete agreements. All have been stalled mostly by the lobbying power of large innovative Washington-based companies like Amazon and Microsoft. After a bill that would have, among other things, limited non-competes to one year faced strident opposition from businesses, Washington legislators revised the bill to make non-compete agreements more transparent. Bill HB 1967, which passed the Washington House on March 8, 2017 and is now in the Senate, would require that all of the terms of a non-compete contract be disclosed in writing before the employee signs the contract.

Ironically, Washington appears to want to follow the lead of California even though it recently was ranked number one for combined job and wage growth, far exceeding California.¹¹ Amazon and Microsoft, the companies that are leading the fight against the non-compete ban, are currently leading the “tech revolution” in Washington. They have a vital interest in protecting their proprietary information – particularly, in preventing employees with specialized knowledge from taking that information to a competitor. It begs the question as to why Amazon and Microsoft would continue to invest in Washington if Washington does not invest in them.

D. Reasonable Non-Competes Foster and Cultivate Innovation

Critics of non-compete agreements often argue that they somehow inhibit innovation. They argue that if an employee is kept from competing with its employer, the employees are essentially prevented from “creating.” However, that speculative argument focuses only on the would-be innovator, and completely overlooks the established entrepreneur. Entrepreneurs (and their investors) invest time, blood, sweat, tears and a significant amount of money in taking an idea from conception to reality. There is no incentive for an entrepreneur to invest in an idea and train and develop employees if one of those employees can take the idea, the customer base or both, move across the street and unfairly compete against the entrepreneur. Without adequate protection from such blatant theft of the entrepreneur’s business, a former employee could unfairly step into the entrepreneur’s shoes and reap the benefits without having to put in the time, money and effort to develop an idea or business, without any of the associated risks.

6 Illinois Freedom to Work Act (IFWA), 5 ILCS 140/1, et. seq.

7 Labor and Employment – Noncompete and Conflict of Interest Clauses, Maryland HB 506 (Jan. 27, 2017) <http://mgaleg.maryland.gov/2017RS/bills/hb/hb0506t.pdf>

8 An Act Relative to the Judicial Enforcement of Noncompetition Agreements, SB 988 (Introduced on Apr. 15, 2015, and accompanied by a study order on Sep. 9, 2016). <https://malegislature.gov/Bills/189/S957>

9 An Act to Promote Keeping Workers in Maine, HPO350, Legislative Document 487, https://legislature.maine.gov/legis/bills/bills_128th/bill-texts/SP029801.asp

10 “A.G. Schneiderman Proposes Nation’s Most Comprehensive Bill to Curb Widespread Misuse of Non-Compete Agreements.” October 25, 2016. <https://ag.ny.gov/press-release/ag-schneiderman-proposes-nations-most-comprehensive-bill-curb-widespread-misuse-non>

11 Torres, Bianca, The Seattle Times, Washington State Ranks No. 1 for Combined Job and Wage Growth (February 15, 2016) <http://www.seattletimes.com/business/economy/employment-and-wage-growth-in-washington-outpacing-other-states/>

An entrepreneur and his or her investors would undoubtedly be reluctant to invest in a project or an idea that could be copied or otherwise undermined with abandon. Although investors complain about the lost opportunities that can result when an innovator is subject to a non-compete agreement, those same investors frequently (and hypocritically) require the use of non-compete agreements for employees of any project that they fund. See Alison Loborn, *Free Labor Market*, Commonwealth, Summer 2009, 35-36. Reasonable non-compete agreements provide an important incentive and a layer of protection for an entrepreneur (and his investors) to innovate. Banning non-compete agreements all together would remove that incentive and layer of protection for the entrepreneur and his investors and would instead stifle innovation by precluding the protection of innovation and investment in innovation.

E. To Be Fair, Non-Competes Are Voluntary In Nature

Those who support a ban of non-compete provisions typically claim that they prevent employees from freely walking away from a job. As explained in a recent New York Times article, blue collar workers who often do not understand non-compete provisions, sign without realizing the implications and without attempting to negotiate.¹² However, while the law on non-competes varies from state to state, in every state, signing a non-compete agreement is voluntary. An employer may require that certain employees sign a non-compete as a condition of employment, but an employee can certainly refuse to sign the agreement and seek employment elsewhere. See e.g. *Kelly Services v. Marzullo*, 591 F. Supp. 2d 924 (E.D. Mich. 2008) (In discussing the potential harm suffered by the employee by not being able to compete in Texas, the Judge noted “this is certainly a risk he calculated and undertook both when he first signed the Agreement and when he decided to leave [the former employer] and go work for a competitor.”). Moreover, critics fail to consider that without adequate non-compete protection of company trade secrets, goodwill or customer relationships, for example, a company could lose business or go out of business and numerous employees could be out of work, creating an even greater negative economic impact.

CONCLUSION

When applied to appropriate levels of personnel, reasonably tailored non-compete agreements, along with other types of restrictive covenants, promote and nurture innovation and serve to protect entrepreneurs’ ideas, investments, goodwill and other legitimate business concerns. The arguments presented by critics of non-compete agreements fail to take into account the full economic effect of such agreements, resulting in a flawed analysis and the empirical evidence used to support their argument is unconvincing. Unfortunately, the negativity surrounding greedy employers seeking to enforce unreasonable non-competes overshadows the positive impact of reasonable non-competes and leads to overreaction, including the demand for legislatures to limit or entirely ban non-compete agreements. Reasonably tailored non-compete agreements do not prevent individuals from earning a livelihood, they are not mandatory and the potential outlawing or limitation of such agreements fails to account for the potentially larger effect on business and other employees. Non-compete agreements have played an important role in market economies for centuries and there is no legitimate basis to change the legal landscape in any state.

¹² Dougherty, Conor, NY TIMES, How Noncompete Clauses Keep Workers Locked In (May 13, 2017) https://www.nytimes.com/2017/05/13/business/noncompete-clauses.html?_r=4.

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