Non-Compete Agreements: What Are They? Who Should Sign Them? Why Would You Use Them?

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Restrictive covenant agreements have become a major feature of the business landscape in the United States. If you are a lawyer, then all you have to do is do a search for the term "non-compete" on Lexis or Westlaw and you can find tens of thousands of hits as the case law on these agreements proliferates. Or, if you are a layman with a functioning Internet connection, you can simply type the term "non-compete agreement" into Google and you will learn that the country's most popular search engine has returned 10,400,000 results.

- Restrictive covenant agreements are often referred to as "non-competes," even though a non-compete provision is only one form of a restriction that can be found in a full agreement. For instance, an employment agreement will often contain a non-compete (employee cannot compete in a certain geographic area) provision, as well as customer and employee non-solicitation paragraphs and a non-disclosure of confidential information restriction. Because of the common use of the term "non-compete agreement," I will use that term and "restrictive covenant agreement" interchangeably in this article, even though the latter is more accurate.

When I ran this search while writing this article, the first three results on Google are paid advertisements for free non-compete agreements. One such web site asks a series of questions and then spits out a draft agreement.

To see whether there was any legal substance to the site, I answered the questions so as to produce a five-year non-compete agreement interpreted under California law. The site then dutifully gave me just what I asked for, despite the fact that California has an almost-complete ban on non-compete agreements in the employment context.

This little exercise is useful to illustrate the first maxim of using non-compete agreements: Just because you draft it and an employee signs it doesn't mean that a court will enforce it. In most contractual contexts, courts will not second-guess the deal struck by two parties.

However, there are exceptions to the rule of deference to contracting entities. One such instance is the signing of a non-compete agreement by an employee. Courts often pay attention to the disparity in bargaining power between an employer and employee, especially when an employee signs an agreement at the outset of employment, a time when everything appears to be rosy on the horizon.

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Few employees start a new position thinking about what is going to happen when the job ends, so courts will often intervene to save employees from their own willingness to cede too much in a restrictive covenant.

The way that courts address non-compete issues varies based on the jurisdiction, which illustrates the second maxim of using restrictive covenant agreements: State law variations are critical. Some states have outright prohibitions on the use of non-compete restrictions in the employment context. Some states allow judges to mark through offending paragraphs, but do not allow judges to modify or rewrite the restrictions. Some states allow judges to modify the provisions, but leave that right up the discretion of the court. And then some states require that judges modify restrictions to make them reasonable, so even if an employer shoots for the moon with a restriction, it can do so secure in the knowledge that a judge will have to bring the provision back to earth.

Thus, knowing the law of the state in which an employee will work and adapting the agreement to that state's legal regime is vital. Additionally, some states have requirements that impact the process of having employees sign restrictive covenant agreements, so the process matters, as well as the substance.

For instance, there are a number of states that set forth that only certain categories or employees can sign restrictive covenants, or that some employees cannot be subject to non-compete paragraphs, although they can be subject to other restrictive covenants. This affects the procedural aspects of rolling out agreements. It also hits on a third maxim, which is that an employer needs to think through which employees should be signing particular agreements. For an employer in the hotel industry, there are a variety of options:

- Most lower-level employees do not have exposure to confidential information or key commercial relationships, so they would not need to sign an agreement or, at most, they would sign an agreement specifying their obligations to return company property at the end of their employment.

- Some white collar employees have access to a lower level of confidential information regarding the operation of a hotel business, but are not exposed to key commercial relationships. These employees would need to sign an agreement that restricts them from using or disclosing the company's confidential information, as well as requiring that they return company property at the end of employment. An employer should also include non-solicitation of employees, since most states give great deference to these provisions.

- Moving up the organizational chart, a hotel employer can use additional restrictions to stop employees who work in group sales and are charged with developing commercial relationships with large organizations for the bulk buying of hotel rooms from exploiting those relationships on behalf of competitors. The minimal approach here would just be to restrict sales employees from soliciting business from the customers with whom the employees dealt when working for the prior employer; the maximal approach would be to forbid the employees from performing similar sales functions in a particular territory and/or on behalf of specific competitors.

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similar sales functions in a particular territory and/or on behalf of specific competitors.

- Finally, the higher-level employees should sign agreements with all of the major restrictions: non-compete, customer non-solicitation, employee non-solicitation, non-disclosure of confidential information and return of property. A hotel employer can restrict its executives who play a role in planning the direction of the business from taking the high-level information that they learn from developing and discussing business plans, then go to work for a competitor. The non-compete restriction can be tied to geography, i.e. the area for which the executive had responsibility when working for th employer, or (in some states) it can be competitor-based, stopping the executive from performing similar functions on behalf of specific rivals. As opposed to other industries, the hotel business has high barriers to entry, so preventing executives from going to specific competitors has value, as it is highly unlikely that the executive will be able to create his own competing entity.

The key question for a hotel employer to pose to itself is "can this employee hurt my company if he/she moves to a competitor and, if so, how would he/she do so?" An honest answer to this question will be a useful guide in determining the particular covenants that should govern an employee's conduct after the end of employment. An employer also needs to ask itself about the cultural effects of rolling out new agreements. Some companies have a tradition of using non-compete agreements such that employees are used to signing them; others do not have that tradition and therefore need to use care to avoid generating employee dissension.

There are a number of reasons why a hotel employer would choose to use restrictive covenants with its employees. The most obvious reasons are that these agreements can be used to protect the employer's most critical information and relationships. However, there are other, less obvious benefits:

- Restrictive covenant agreements can deter an employee from moving to a competitor. An employee who really wants to leave is going to do so no matter what. However, for an employee who is going through a bad period, the existence of a restrictive covenant can deter that employee from making an impulsive move. Likewise, a non-compete agreement can prevent an employee from making a move solely for a short-term gain or, in a related scenario, it can deter a competitor from trying to hire the employee who is subject to the agreement. It is likely that a hotel employer will never know what moves its non-compete restrictions deterred, but that does not make the value of the covenants any less real.

- Restrictive covenants help employers show the existence of trade secrets. An employer does not need an agreement in order to stop its former employees from using or disclosing trade secrets. Trade secret protection exists under either statutory or common law in every state. However, one of the necessary elements to proving the existence of a trade secret is to show that the holder took reasonable means to protect the secrecy of the information or material in question. An employer can show reasonable means through a variety of different methods: physical security, IT policies, exit procedures, etc. One of the most common elements upon which employers rely

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to show reasonable means is a restrictive covenant agreement that stops employees from taking various steps on behalf of a competitor.

- Restrictive covenants help to educate employees. Some employees take a self-serving view of what they own as compared to what their employers own. "I made it, therefore I can do whatever I want with it" is a not-uncommon sentiment, especially after an employee's time with a company ends. The concept of "your employer was paying you to make it, therefore your employer owns it" can be ignored, either willfully or unintentionally. When an employer has an employee sign a non-compete agreement that details the information and materials that the employer values most highly, the employer is educating the employees on this subject. By doing so, the employee who would inadvertently retain and use company property will be less likely to do so. The employee who would intentionally do the same cannot claim that he/she was unaware of the consequences.

In closing, restrictive covenants can be a powerful tool for employers for a variety of reasons. However, as with most powerful tools, it is important for an employer to use these contracts responsibly. An employer needs to make sure that its agreements protect its interests in the least burdensome manner possible. Even the states that are pro-enforcement of restrictive covenants will look at this factor. An employer also needs to pay attention to state requirements for both the substance of the restrictions and the procedures by which they are signed. Lastly, an employer needs to think through the optics of the roll out so as to minimize the grumbling that can sometimes result from using restrictive covenants. An employer that pays attention to these factors will find itself in the best possible position to protect the relationships and information that form a large portion of the company's list of assets.

This article by Michael Elkon was featured in Hotel Executive.

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