Non-Compete Agreements: Harder to Enforce?

Labor & Employment

Many businesses have embraced a more aggressive use of non-compete agreements and other post-employment restrictive agreements in recent years. But the broadened use of such agreements has led to increased litigation, and a number of courts are signaling that they are becoming less willing to enforce them.

Companies generally believe that non-compete agreements and other post-employment restrictive covenants are an important tool for protecting their business, including minimizing the leakage of valuable intellectual property. The use of such agreements has evolved. Two decades ago, non-compete agreements were used primarily for senior executives—people who knew the ins and outs of the company's business and could cause real competitive harm by moving to a rival company. But over the years, companies began using the agreements with more and more types of employees. "You started to see it extended to VPs and directors and other mid-level managers," says Tom Gies, a founding member of Crowell & Moring's Labor & Employment Group. "The increased use of stock options and other equity grants also broadened the use of non-competes, as many companies imposed such agreements as a condition of receiving equity."

In addition to non-competes, most companies use some form of post-employment restrictions barring departing employees from soliciting other employees, pursuing customers of their former employer, or disclosing a company's confidential business information. Companies are pursuing more trade secret misappropriation and related business tort claims to address the problem of IP leakage. "This is not just technology companies. Most companies don't want competitors to get valuable information about customers, pricing, profits, and marketing strategy," says Gies. "If an employee leaves and takes that knowledge across the street, it could really hurt a company."

That trend has also been driven by the Defend Trade Secrets Act, enacted by Congress in 2016, which allows companies to bring suit in federal court when they believe that their trade secrets have been misappropriated.

Like many trends, this one may have gone too far. Several years ago, the Jimmy Johns food chain received a lot of negative publicity by requiring most of its employees, including lower-wage delivery drivers and sandwich makers, to sign non-competes. The agreements said that if they left the company, they could not work at nearby companies that earn more than 10 percent of their revenue from sandwiches—for two years. The company settled lawsuits in New York and Illinois over the issue and eventually announced that it would not try to enforce those agreements.

As companies become more aggressive in trying to enforce post-employment restrictive covenants, "there's been a fair amount of pushback by courts that are skeptical of attempts to enforce them and less inclined to grant temporary restraining orders against former employees, particularly medium- and lower-level employees," says Gies. Some courts appear reluctant to enforce

Mandatory Arbitration: The Battle Continues

Several recent Supreme Court rulings have strengthened the use of mandatory arbitration to resolve disputes with both employees and consumers.

Those rulings have largely been welcomed by business, which sees arbitration as a way to reduce litigation costs. "But there is considerable resistance in other quarters, including several state legislatures, plaintiffs' lawyers, and various advocacy groups," says Crowell & Moring's Tom Gies. The #MeToo movement has brought public attention to the issue by arguing that private arbitration makes it possible to cover up allegations of sexual misconduct. Several states, including California, New York, and New Jersey, have passed laws in the past two years that broadly restrict the use of mandatory arbitration and ban the use of confidentiality provisions in settlement agreements. Last September, the U.S. House of Representatives passed the Forced Arbitration Injustice Repeal Act (FAIR), which prohibits companies from requiring employees to use private arbitration.

These tensions will likely lead to more arbitration-focused litigation—and companies should review their agreements. "The law has moved at light speed," Gies says. "Many agreements that were well crafted a few years ago probably won't get you where you need to be."

"Enforcing non-competes and other restrictive agreements may no longer be the slam dunk case that companies think it is." **Tom Gies**

agreements that could essentially limit a person's right to make a living—especially where the mid- or low-level employee did not have much bargaining power when hired. And in a time when company-employee loyalty has all but disappeared, some courts may view switching jobs as a "new normal," as employees seek to advance their careers through lateral moves.

Non-competes aren't the only agreements being called into question in recent litigation. For three decades, the law in California allowed companies to enforce carefully drafted employee non-solicitation agreements. But in May 2019, the Northern District of California ruled in *WeRide Corp., et al v. Kun Huang, et al* that such agreements were void because they were an invalid restraint on employment. Two previous California cases had produced similar results, but they involved the recruiting business; *WeRide* did not. "A 35-year-old precedent has been knocked on its head a little bit," says Gies.

State statutes reflect the trend of pushing back against the overly aggressive use of post-employment agreements. California has long banned non-competes by statute, and other states have been moving along those lines and limiting the ability to enforce such agreements. Over the past year, Maine, Illinois, New Hampshire, and Maryland passed laws banning non-competes for low-wage workers, while recent Washington state legislation banned them for employees making less than $100,000 annually.

Case law continues to evolve. "A lot of non-compete agreements say that an employee can't go work for a competitor in any capacity—full stop," says Gies. Now a growing number of courts are rejecting those agreements for being too broad, under what has become known as the Janitor Rule. "If you are in IT at a company, why couldn't you go work for someone else as a marketer, a truck driver, or a janitor?" he asks. "Some courts tend to believe there is no real legitimate concern that the former employer would have about that. So there are now half a dozen states that recognize some version of the Janitor Rule."

As a general trend, courts in many jurisdictions are increasingly saying that the existence of restrictive agreements, in and of themselves, is not enough to justify enjoining someone from working elsewhere in the same industry. "This just doesn't sit right with many judges when you're dealing with lower-level employees or where there's no evidence of misconduct," says Gies. All in all, he says, "enforcing non-competes and other restrictive agreements may no longer be the slam dunk case that companies think it is—and that is catching some of them by surprise."

In this environment, enforceability often depends on gathering information showing that the former employee is harming the company. "It's all about getting evidence of skullduggery," says Gies. "Did they take confidential information home or send it to their new employer? Did they start contacting your customers about their move? Have they been soliciting their former co-workers to join them?"

A cornerstone of that effort is, of course, the forensic analysis of computers. "Often people leave tracks that they've sent the company's secret sauce or spreadsheets of customer lists and pricing to their personal email, or downloaded them onto a thumb drive," says Gies. "Then you go to a judge and say, 'This person left in a huff and wouldn't tell us where he went. He downloaded 3,000 documents to his home computer and won't let us look at that.' If you can get that kind of evidence, you have a pretty good case." The importance of taking preventive measures when employees jump ship for a competitor may seem obvious, he adds, but in practice, companies sometimes fail to perform these analyses and simply wipe a departing employee's laptop clean and recycle it for use by others.

Judges are typically open to enforcement lawsuits that feature evidence of wrongdoing, Gies continues. He points to a case in which Waymo, Google's autonomous driving subsidiary, sued a former key engineer for allegedly downloading nearly 10 gigabytes of confidential files before leaving to start his own company and, eventually, joining Uber. He was later fired by Uber for not cooperating in an internal investigation and indicted for taking or attempting to take Waymo's trade secrets.

Companies need to be mindful of the current environment in their recruiting strategies. "As you hire talent, find out if they are party to an agreement and review it. Then write a letter affirmatively disclaiming any interest in information they might have from their former employer. And throughout the onboarding process, make sure that you are minimizing the risk of hiring talent from a competitor and receiving any confidential information," he says. While companies typically have such policies in place, they may want to increase their scrutiny of new employees and include more levels in those processes.

Overall, companies should keep a close eye on the courts' evolving views of restrictive employment agreements and make sure their own agreements—and their expectations about enforcing them—reflect that changing landscape.