

ARE YOUR NON-COMPETES ENFORCEABLE?

Many employers rely on non-competition agreements to protect their intellectual property and customer relationships from misuse and misappropriation by departing employees. Recent Massachusetts court decisions, however, have created uncertainty regarding employers' ability to enforce these "restrictive covenants" in some situations. This edition of the *Employment Law Advisor* focuses on steps employers can take to enhance their ability to enforce these agreements and avoid the pitfalls which may render them unenforceable.

THE BASIC GROUND RULES

Most employers are familiar with the different types of post-employment restrictive covenants. A "covenant not to compete" generally is an agreement that the employee will not engage in business competitive with his or her employer for a certain time period following the termination of his or her employment. A "non-solicitation agreement" generally provides that for a specific time period post-termination the employee will not solicit the same type of business from customers with whom the employee dealt while employed by the prior employer. An "anti-piracy" provision (which is often also called a non-solicitation provision) restricts a former employee from soliciting remaining employees to work for the employee or his or her new employer.

In general, in order to be enforceable, a restrictive covenant must (i) protect an employer's legitimate business interests, (ii) be reasonable in time and scope, (iii) be consistent with the public interest and (iv) be supported by consideration. The two key protectable employer interests are (i) an employer's relationship with customers, clients and vendors (also called "good-will") and (ii) trade secrets and other confidential proprietary information.

CONSIDERATION

Any agreement, including a restrictive covenant, has to be supported by "consideration" in order to be enforceable. This means each party to the agreement has to receive a benefit from the other party – either a promise or something of value. When an employee is presented with such a restrictive covenant prior to employment, there is no question that consideration exists to support the agreement since the employee receives an offer of employment.

Practical Tip: If an employer wants a new hire to sign a restrictive covenant, the employer should make this condition clear prior to hiring the employee. The employer should clearly outline this requirement in an offer letter (and, preferably, attach the non-compete/non-solicit agreement to the offer letter) so that the employee cannot later assert that

the restrictive covenant was imposed after he or she accepted the offer of employment.

CONTINUED AT-WILL EMPLOYMENT MAY NOT PROVIDE CONSIDERATION

Often employers do not require an employee to sign a restrictive covenant at the outset of employment (for a variety of reasons), but impose the agreement later. For years employers have taken the position that simply continuing the at-will employment of an employee required to sign such a "mid-employment" agreement was sufficient consideration to enforce the agreement. The law in this area is not entirely clear —although the Massachusetts Appeals Court found that continued employment was sufficient consideration to support such a non-competition agreement imposed on an employee during employment, a Massachusetts trial court recently has found to the contrary. Given the unsettled nature of the law, we recommend that employers offer the employee something of value in exchange for the agreement. This consideration can be in the form of additional compensation, such as a raise, bonus, stock options, or even acceleration of a benefit, and may be offered in conjunction with a promotion.

CHANGES IN POSITION MAY RENDER A NON-COMPETE UNENFORCEABLE

Over the past six months, three Massachusetts trial court judges have held that where an employee who had signed a restrictive covenant at hire has a change in position (such as a promotion) and did not execute a new restrictive covenant, the original agreement is unenforceable. Consequently, employers can no longer assume that a non-compete agreement will continue to be valid following a change in the employee's job.

The most recent of the three decisions, *Lycos, Inc. v. Jackson* (Aug. 24, 2004), concerned an employee, Chun, who signed a restrictive covenant at the outset of her employment in March 2000. Lycos promoted her, later demoted her, and then promoted her again in March 2004, when Lycos gave her an offer letter to sign and return. This offer letter referenced the restrictive covenant she had signed at the outset of her employment. Chun failed to sign and return the offer letter, and quit a few months later. The court found that the changes in Chun's position were material changes in the employment relationship, requiring a new restrictive covenant to be signed, and refused to enforce the March 2000 agreement.

The *Lycos* decision (and others) puts employers in a difficult situation because, as a practical matter, it will be difficult administratively to require a new restrictive agreement each

time an employee's position changes. One potential solution to this problem is suggested by the *Lycos* decision itself: at the time of an employee's promotion, require that the employee sign a document acknowledging the promotion and that any previously entered into agreements, including restrictive covenants, remain in effect. Of course, if the employee refuses to sign the acknowledgment, the employer's position is weakened because the employer's request for a signed acknowledgment raises the inference that such an acknowledgement was necessary. Because the employee may refuse to sign such an acknowledgement, an employer should not ask for it unless the employer is willing to (i) not make the offered promotion, (ii) terminate the employee, or (iii) risk losing the benefits of the original restrictive covenant.

Another recommended practice to combat this problem is to include in all restrictive covenants language which anticipates this situation, putting the employee on notice that the covenant will remain in effect for the entire period of the employee's employment with the employer, regardless of any changes in the terms and conditions of employment, including changes in duties, position, and compensation. Massachusetts courts, however, have not yet ruled on whether such language succeeds in enabling an employer to enforce a pre-existing agreement after an employee's position has materially changed.

Another pitfall in this area is highlighted by *R.E. Moulton v. Lee* (June 17, 2004). There the employee, Lee, entered into a non-compete agreement and received as consideration participation in a bonus plan. The agreement explicitly stated that it was due to Lee's position as a management level employee. Later Lee switched to a non-management position and ceased participation in the bonus program. Lee's non-compete was not amended, and Lee was not notified that he was still subject to the non-compete clause. When the company was sold, other employees were asked to sign new non-compete agreements, but Lee was not. The Superior Court refused to enforce Lee's non-compete agreement because of the substantial changes in Lee's position which conflicted with the express language in the agreement.

Practical Tip: Avoid specifying the employee's position in the language of the restrictive covenant.

ANTICIPATE POSSIBLE BREAK IN SERVICE

Case law, both older and more recent, suggests that an employee who signs a restrictive covenant, leaves

employment, and then returns later, may no longer be subject to the original agreement. To reduce the possibility of this situation, include in the agreement a provision that states that in the event the employee has a break in service (*e.g.*, leave of absence or time away from employment), the agreement will continue to apply to the employee.

ADDITIONAL POINTS

Although courts consider many issues when evaluating the enforceability of a restrictive covenant, given space limitations, not all can be discussed in this issue of the ELA. In brief, however, here are several additional steps employers can take to strengthen their agreements:

- Keep confidential information confidential - Courts will examine whether an employer truly treats its alleged confidential and proprietary information as secret when considering whether a protectable business interest is at stake. Developing a program to protect proprietary information and trade secrets will enhance an employer's position that its business information is in fact confidential and therefore protectable by a restrictive covenant.
- Anticipate assignment - Include in the agreement a provision permitting the employer to assign the agreement to an acquirer; otherwise the acquirer is unlikely to be able to enforce the agreement.
- Impose attorneys' fees on the employee for breach - Include a provision requiring the employee to reimburse the employer for its attorneys' fees if the employer has to sue to enforce the agreement. Such a provision can provide substantial leverage to an employer to prevent a breach of a restrictive provision.
- Avoid dilution - Only ask employees who have the ability to abuse the employer's goodwill or confidential information to execute restrictive covenants. If every company employee from the janitor to the CEO is expected to sign a restrictive covenant, a court may question whether protectable interests are truly at stake.

CONCLUSION

To be enforceable, restrictive covenants must be supported by consideration. In light of recent Massachusetts court decisions, employers should review their agreements and practices. Taking the steps outlined above will go a long way towards protecting the enforceability of these agreements.

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