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NON-COMPETE AGREEMENTS and THEIR ENFORCEABILITY

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a. What is a non-compete clause?

A non-compete clause (or covenant not to compete) is a term used in contract drafting, and it refers to an agreement under which one party, usually an employee, agrees to not pursue a similar profession or trade in competition against another party, usually the employer. Employers require employees to sign non-compete agreements in order to maintain a competitive edge in the market. These agreements seek to prevent the employee's abuse of confidential information and trade secrets obtained from his earlier employment.

Here is an example of what a non-compete clause might look like:

For a period of one year after the termination of this Agreement, within 50 miles of Company's headquarters, Employee shall not directly or indirectly, for his own benefit or for or with any person, firm or corporation whatsoever other than Company's, engage in any business that directly involves home construction and that competes with Company.

Non-compete clauses typically are comprised of three elements: (1) The time-frame during which the employee is restricted; (2) the geographical area in which the employee is restricted; and (3) the conduct/employment with respect to which the employee is restricted.

b. Will courts enforce a non-compete agreement?

An employee of yours signs an employment contract that contains a non-compete clause prohibiting the employee from taking employment with a competitor. The relationship quickly deteriorates, and the next thing you know, the former employee has taken a position with a fierce competitor. Your primary concern is that your former employee will use confidential information and trade secrets (which could include contact lists) to advantage your competitor. You attempt to address your concern by amicably discussing the situation with your competitor. However, your competitor is quite satisfied with your former employee's performance and has no intention of letting him go, much less making him do so. Your only remaining course of action is to seek an injunction against the former employee. To do this, a court will have to review your employment contract and determine whether your non-compete can serve as a basis for the injunction.

1. The degree of enforcement afforded to non-compete clauses will depend largely on the state where enforcement is sought.

The validity of contracts is generally determined by state courts. As such, the validity and level of enforcement afforded to non-compete clauses will depend on the state in which enforcement is sought.

In a few states, such as California, for example, non-complete agreements are illegal. Because of public policy considerations, namely, interfering with an individual's ability to make a living, California expressly voids any such agreement: "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."

Courts in most states, however, do enforce non-compete agreements to some degree at least. In these courts, the cornerstone for enforcement is reasonableness. If a non-compete clause is reasonable in its totality, it will be upheld. On the other hand, if a reviewing court finds that the clause as drafted is unreasonable, it may do one of two things, depending on the state court. In some states, the court may “blue pencil” the clause and edit it to the point where it would be reasonable if it had been so drafted originally. For example, if a non-compete restricts certain types of employment for a period of 30 years – a period clearly unreasonable, a court may revise the paragraph and insert a duration of 2 years in place of 30 years to create a valid non-compete agreement.

Other state courts are not so accommodating and will delete the entire non-compete paragraph from the agreement if they find that a non-compete paragraph as drafted is unreasonable in the slightest. As an example, if a court typically finds that the duration of a non-compete clause in a given industry should be no more than 2 years, it may completely delete a non-compete clause containing a 3-year duration period. Practically speaking, this would mean that the employee would be free to pursue any employment without restriction even within a 2 year period of termination.

2. What will courts look at to determine the validity of non-compete agreements?

Consideration. Many courts will first look to see whether *consideration* was received by the employee in exchange for his agreement. *Consideration* is not a concept unique to non-compete agreements; rather it is a requirement for all valid contracts in the United States. The idea behind consideration is to ensure that each party to a contract is receiving some benefit from that transaction – that the contract is not a one-sided exchange. If I purchase a car from you, each of us receives consideration - you get money, and I get the car in exchange.

In most cases where a non-compete clause is inserted in an employment agreement there is valid consideration. The soon-to-be employee is receiving the benefit of a promise of employment, and in exchange, the employer is benefiting by the employee’s promise to perform as a worker.

What one needs to look out for are cases where an employee or contractor is signing the non-compete agreement as a stand-alone agreement and is receiving no *additional* benefit for signing that agreement. Thus, where an employee already has signed an employment agreement and has been working for some time, the employee needs to receive some *additional* benefit as consideration for signing a non-compete agreement later on.

Reasonableness. Courts that do enforce non-compete agreements will do so only when the agreements are reasonable as a whole. Typically, three elements will be looked at to determine whether the agreement is a reasonable one. **1) Duration:** What is the duration of the agreement – for what period of time will the employee be restricted under the agreement? Whether a particular duration is reasonable will depend on a number of factors, such as industry and location. In the high tech industry, for example, courts will expect shorter duration periods because of the fast-moving nature of the industry. It would be unreasonable to prevent an employee from seeking employment with a high tech competitor 5 years after his employment terminates, when the competitive elements likely will have changed dramatically. **2) Area:** In how large a geographic area does the non-compete agreement restrict the employee? Again, whether the restriction over a given geographic area is reasonable will depend on the type of industry and employment at issue. Today, especially in the high tech and internet industry, this element is becoming less and less relevant because many companies operate throughout the United States and competition is not limited to any given geographic area. **3) Nature of Restriction:** How broad are the restrictions in the non-compete agreement? The broader the restrictions, the more likely it is that a court will find the agreement to be unreasonable. A court may honor the agreement up to the point where it finds that the restriction legitimately is needed to protect the former employer’s interests.

c. **Conclusion.**

Non-compete agreements are enforceable in the majority of states, at least to some degree. But it is important to keep a couple of things in mind when considering a non-compete agreement as a way to maintain a competitive edge in the market. First, remember that many jurisdictions require that the employee receive some benefit for signing a non-compete agreement. This is not usually a problem if the non-compete is embedded in an employment agreement because in such a case the employee's benefit is the employment itself. Second, the non-compete agreement must be reasonable with respect to its duration, geographic area, and the nature of its restrictions. If it is unreasonable, some courts will remove the entire non-compete clause instead of revising it. As such, it is wise to narrow the non-compete agreement as much as you can while still protecting your interest.

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