Published on *The National Law Review* https://natlawreview.com

Noncompetes in Flux: What Else Can Employers Do to Protect Themselves?

Article By:

Amir E. El-Aswad

As we continue to report, noncompete agreements have been subject to unprecedented scrutiny over the past few years. Last April, the Federal Trade Commission (FTC) finalized a rule ("Final Rule") ostensibly banning noncompetes, which has been mired in **significant legal challenges**. Additionally, four states have banned noncompetes (California, Minnesota, North Dakota, and Oklahoma), and the list continues to grow, with Ohio recently joining the list of states with proposed bans. In light of these developments, we have provided guidance to employers seeking to incorporate noncompete provisions in their employment agreements. However, employers in states with existing or proposed noncompete bans can still protect their legitimate business interests through other tools, even without ordinary noncompetition agreements.

Noncompetes Incident to the Sale of a Business:For starters, even if ordinary employment-based noncompetes are banned, there may be exceptions to the general prohibition. For example, the FTC's ban on noncompetes contains an express carveout for the "bona fide sale of a business entity, of the person's ownership interest in a business entity, or of all or substantially all of the business entity's operating assets." Even California — widely regarded as one of the most hostile jurisdictions toward noncompetes — will enforce noncompetes when they are part of the sale of a business or its associated goodwill and the dissolution of a partnership or limited liability company. Employers must exercise caution in determining whether a specific transaction, along with the individual's involvement, meets the criteria for the relevant state's sale of business exception.

Non-Solicits: If employers are prohibited from implementing noncompetes in their employment agreements, the FTC's Final Rule and many states with noncompete bans nevertheless permit certain non-solicitation agreements. Of course, employers will want to carefully review the laws of each state in which they operate to ensure that their non-solicitation agreements are reasonable and enforceable. Some non-solicitation or "no-poaching" agreements, particularly those that apply to customers, might be deemed similar to a noncompete and rendered unenforceable. By contrast, non-solicits applicable to employees generally survive stricter scrutiny. Regardless, employers must narrowly tailor their non-solicitation agreements to protect the employer's legitimate business interests and must ensure they are reasonable terms of duration and scope. Employers should also be careful about adding new non-solicitation obligations to existing employees, as some states require existing employees to receive new consideration, including material elevations in position or stock awards, for the new obligations to stick.

Non-Disclosure (NDAs) and Confidentiality Agreements: Despite the turbulence surrounding noncompetes, employers may still protect their legitimate business interests through NDAs and confidentiality agreements. NDAs generally limit employees from using, sharing, or disclosing confidential information and trade secrets obtained from their employers during and after employment. While similar to NDAs, confidentiality agreements tend to be broader and focus specifically on protecting sensitive information. Employers should understand, however, that NDAs included in certain settlement agreements may be subject to heightened scrutiny and regulation.

Non-Disparagement Agreements: Employers should also consider implementing reasonable non-disparagement provisions in their employment agreements. Such provisions generally prohibit or limit employees from making negative statements about their employers during and after employment. While such provisions can help protect an employer’s image and mitigate fallout from turbulent terminations, employers should be careful not to draft their non-disparagement agreements to be overly one-sided or impose unfair burdens on a single party. Employers should also be cognizant that non-disparagement agreements included within severance agreements tend to be subject to stricter scrutiny and regulation.

Liquidated Damages: Finally, employers may reduce the administrative burden of protecting their legitimate business interests by including reasonably tailored liquidated — or stipulated — damages provisions. These provisions specify a predetermined amount as damages for an employee’s breach of their restrictive covenants. Generally, a liquidated damages provision will be upheld where it would be impracticable or extremely difficult to calculate the actual damages for the breach of a provision when the contract was made and the amount set as liquidated damages represents a reasonable estimate of fair compensation for the loss sustained. Accordingly, a liquidated damages provision could greatly expedite any litigation resulting from a breach of a restrictive covenant by shortcutting the otherwise time-consuming and expensive process of identifying an employer’s actual damages resulting from a breach. To ensure these provisions are reasonable, however, employers should carefully draft liquidated damages provisions for each restrictive covenant at issue, as some courts may find that universally applicable liquidated damages do not accurately estimate the damages sustained if they proscribe the same remedy for breaches of materially different covenants.

While the legality and enforceability of noncompetes may be in flux, employers still have several tools to protect their legitimate business interests upon an employee’s departure.

National Law Review, Volume XV, Number 104