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Restrictive Covenants: Looking Beyond The Criticism

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Noncompete provisions and other restrictive covenants have been harshly criticized in the press in recent months. The disapproving reports tend to highlight selected cases, involving relatively low-level labor positions and circumstances that appear, at least at first glance, to result in harsh and unfair outcomes. Given the widespread use of restrictive covenants, and the number of employees and businesses involved, it is a rush to judgment to review a few cases and conclude, uniformly, that restrictive covenants are unfair to workers and have purely negative economic impacts.


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The truth is much more nuanced and complex. Restrictive covenants, including noncompete provisions, can be utilized and enforced while maintaining the delicate balance between an employee's right to work and an employer's right to protect its business.

With some differences from state to state, the law permits varying levels of restrictions to be utilized, but only to protect legitimate interests of the employers. Even then, the restrictions face a reasonableness test. Moreover, the majority of restrictive covenants utilized are client or customer-based restrictions which do not prohibit a former employee from working. Accordingly, there are already a number of protections built in to the system.

Moreover, it greatly oversimplifies the matter when commentators lump together different types of restrictive covenants — including pure noncompete agreements, nonsolicitation and nondealing agreements, nonpoaching provisions, and confidentiality clauses. These concepts are distinct and can be utilized with or without some or all of their counterparts. It is incorrect to think of them all as "noncompetes." For example, a clause saying an employee cannot work for a competitor anywhere in the world for three years following the termination of employment is much different from a clause requiring 60 days' advance notice of a resignation and precluding the employee from soliciting the company's clients for a period of time. It is not intellectually rigorous or fair to group these, and all of the provisions in between, in a broad category. For example, in the vast majority of states a broad, unpaid noncompete will not be enforced for three years against an employee, unless that employee has sold his or her business, but other less restrictive covenants might be enforced.

In any event, employers have long believed — and the courts tend to agree — that there are good and

valid business reasons to utilize restrictive covenants, and that doing so protects both the businesses at issue and its other employees. The protection of confidential information and trade secrets sits atop the list of protectable interests, and these are easy to distinguish from accumulated skills that make workers valuable. Accumulated skills are not a basis to enforce a restrictive covenant in any state, while truly sensitive confidential information and trade secrets are. Furthermore, the mere exposure to confidential data and trade secrets (even the company's most valuable information) is not alone a basis to enforce a restrictive covenant, unless the employee's new position would require the employee to inevitably disclose that information he or she learned at a former employer when performing the duties and responsibilities in his or her new position.

Additionally, many of the cases where restrictive covenants are enforced arise in situations where the employees actually took actual confidential information and/or trade secrets, with the intention of using them improperly in the employee's new job with a new employer. They may also arise in situations where the employee has surreptitiously taken steps to compete before switching employers. Of course, these cases are not highlighted by those critical of restrictive covenants.

And while adherence to a restrictive covenant might impose a burden on the employee retrained, breaching a restrictive covenant is not at all a victimless crime. When an employer suffers from unfair competition, the employees take the brunt of the impact. If an employee unfairly competes with a former employer and takes its business in a prohibited manner, the former employer will lose revenue and other employees may lose their jobs due to lack of work. If an employee unfairly solicits and takes client relationships, then those other employees who supported the same client relationships may lose income and/or their own employment. And the new employer who benefits from this sudden influx of clients has not had to support the organic growth of these clients over time, has employed less people to get this business, and therefore may gain an unfair advantage. This has an impact on the workforce in much the same was as consolidation in an industry causes the loss of jobs.

Put another way, employers expend substantial resources training employees and empowering them to succeed. Restrictive covenants can protect that investment, so that another company does not unfairly take advantage of all those expenditures. Restrictive covenants can also protect a company's "goodwill," such as customer and other business relationships. Thus, noncompete, nonsolicit, nondealing and/or nonpoaching agreements are designed to protect the business as a whole and all of its employees. This is increasingly important as economic growth is increasingly seen in business-selling services rather than goods. No one would criticize a business-selling widget from installing an alarm system on its warehouse or hiring a watchman to prevent theft. But for businesses providing services, their most valuable asset is their roster or list of clients. A good way that these client relationships can be protected from theft is through the use of restrictive covenants.

Businesses are not all evil monoliths. They are run by people for the benefit of many. Employers often take entry-level workers, train them with skills, arm them with data and connections, and advance them through the ranks. And there is no shortage of employers who have stood by their employees through financial downturns in the economy and/or the business. If we want to encourage businesses to train and advance their employees, and to stay loyal to them through difficult times, then the companies must be entitled to certain reasonable protections.

To be sure, restrictive covenants are not appropriate in all circumstances and some businesses overreach in utilizing and enforcing them. Increasingly state legislatures are discussing altering the status quo for enforcement to account for certain overreaching behavior. In addition, state's attorneys general are also investigating the inappropriate use of such covenants. Ultimately, much as the courts

have done, the legislatures may further crystallize what is and what is not permissible.

In the end, the system is not perfect. Sometimes businesses with very good reasons for enforcing a restrictive covenant cannot obtain the relief they want. Sometimes employees with very good reasons for wanting a new job cannot move as easily as they want. But the unequivocal conclusion that restrictive covenants are “unfair” or “bad” for the economy is hasty and unreasonable. In any event, a move to a system with a blanket prohibition against these protections would be more disastrous to the workforce than the perceived harm it seeks to address. Even if you disagree with the notion of restrictive covenants, it is important to understand why they are used and that, in at least some circumstances, they make perfect sense.

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