Professional Perspective

Maintaining Compliant Restrictive Covenant Agreements

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For years, there has been a steady trend at the state and federal level to try to chip away at contractual protections companies commonly rely upon to protect investments in confidential and trade secret information, R&D, talent, employee training and education, and relationships with clients and other business partners. What began as a targeted attack on overuse of post-employment non-competes with lower-income workers has greatly expanded.

In the face of these unrelenting attacks, multijurisdictional companies have understandably struggled to implement compliant and effective restrictive covenant agreements. That struggle is partly the result of the dizzying patchwork of existing and new state laws and the threats of further state and federal action. But corporate culture has also contributed to the struggle, with some companies operating under an outdated or dismissive view of the import of these new laws and trends. At the other end of the spectrum are companies engaging in what they view as a tactical retreat, when, in fact, they are yielding unnecessary ground. In reality, many of these new laws are not intended to apply retroactively to existing agreements with employees, so companies can take a deep breath and focus on compliance going forward.

This article will address how companies can effectively tackle the current hodgepodge of state laws and future laws by considering some of the main compliance issues, undertaking a strategic reset, and remaining vigilant going forward.

Implementation in the Face of Legislative Trends

One of the key areas of focus for companies considering implementation of restrictive covenant agreements with employees and contractors is compliance with current or pending legislation establishing limitations on the use and enforcement of restrictive covenants such as non-competes and, more recently, non-solicits.

Much of this pending and new legislation focuses on hourly or non-exempt employees or imposes specific compensation thresholds that must be met for such covenants to be enforceable. To illustrate the wide disparity on these issues, companies must recognize that, while some states and pending legislation have focused on hourly or minimum-wage employees, other states have imposed thresholds in excess of $100,000 annually for employees and $200,000 annually for contractors—hardly what one would classify as a low wage. There are many other state-specific hourly-wage or annual compensation thresholds in between. Because there is no uniformity on these issues nationwide, these requirements and pending legislative proposals have caused companies to depart from using a single form restrictive covenant agreement with broad classes of employees.

Companies must also be cognizant of even broader bans on the use and enforcement of restrictive covenants. There have been recent legislative efforts aimed at banning the use of non-competes at any income level as well as efforts aimed at limiting the use of during-employment non-competes and anti-moonlighting restrictions. There have also been legislative efforts aimed at banning the enforcement of post-employment non-competes against employees terminated without cause, although some states may permit such enforcement provided it is embedded within a severance agreement or as part of a paid leave or "garden leave" agreement. There have also been attacks on the use of once sacred non-solicits, with not only compensation thresholds but also a focus on barring non-solicits that aim to prevent a former employee from servicing a customer of the former employer who seeks out the former employee without solicitation.

As companies engage in this analysis they must also consider whether they may be subject to statutory penalties and fines or even civil enforcement proceedings by the government or by "private attorneys general." There is also the potential they will be statutorily liable to cover the legal fees of employees successfully challenging unenforceable restrictive covenants. And companies must come to grips with the realization that a court may not elect to modify, or "blue pencil," an unenforceable agreement in order to make it comply with applicable state law. Indeed, there is a newer but still developing legislative trend aimed at narrowing courts' authority to blue pencil and instead adopting what is commonly characterized as "red penciling"—eliminating, and not rewriting or otherwise salvaging, unenforceable provisions.

Understanding all these risks and requirements is critical to companies as they consider the best approach for their restrictive covenant agreements. But companies must then consider how and when to implement any changes in their

restrictive covenant approaches. As companies consider the best implementation approach, they must bear in mind the variety of procedural hurdles and other nuanced restrictions at the state level that impact the implementation of new restrictive covenant agreements.

There are requirements for notifying prospective employees of restrictive covenant obligations prior to the start of employment. There are a variety of advanced notice periods as long as 10 business days or perhaps even longer by requiring notice as part of the employment offer itself. There are requirements for notifying prospective employees of their right to seek independent legal counsel prior to committing to a restrictive covenant agreement.

There are also requirements at the end of employment, including statutory obligations to notify departing employees of their obligations at the time of termination. Failure to comply risks waiver of the ability to enforce those obligations. There are also now legislative efforts to ban the use and enforcement of certain restrictive covenants with those laid off or furloughed in national emergencies such as with the Covid-19 pandemic, potentially raising unique issues associated with companies re-hiring former employees.

Though often overlooked, many states also impose procedural requirements for those asked to sign new restrictive covenant agreements during their employment. Those requirements can include not only the same sort of advance notice requirements for new employees but also the requirement of additional consideration. These issues are of vital importance for companies that employ restrictive covenant agreements in connection with lateral moves or promotions within a company, compensation changes, or as part of rolling out new form agreements or policies companywide.

Undertaking a Strategic Reset

With the volume of action at the federal and state level, companies must take stock of their nationwide practices in order to remain competitive in a challenging labor market.

Multijurisdictional companies have long confronted jurisdictions openly hostile to post-employment restrictive covenants. Some companies have employed choice of law and exclusive venue provisions aimed at securing the application of another state's more favorable laws and maintaining uniformity in how their agreements are enforced against their employees nationwide. Other companies have used state-specific carveout provisions or "savings clauses" to comply with hostile laws, and others, for ease of administration and recruiting, have abandoned the use of certain restrictive covenants.

Today, however, most would agree that relying upon a single form restrictive covenant agreement for all employees or contractors is a thing of the past for multijurisdictional companies. At a minimum, that approach risks unenforceability and potential civil liability. Companies must now take a deeper dive into their workforce to determine which categories of employees and contractors are required to sign restrictive covenant agreements, where those individuals reside and perform work, and whether and how to comply with stringent and inconsistent legislative requirements across the country.

Among the many effective options available to companies is reconsideration of whether non-compete agreements with certain employees and contractors are even necessary. That analysis is certainly warranted for lower-level employees who may not be entrusted with relationships with key business partners and who do not have access to trade secrets or other valuable information.

Companies can use state-specific forms or state-specific carveouts within nationwide forms to address each state's specific requirements. And, where not prohibited by applicable law, companies may continue to employ exclusive venue provisions and choice of law provisions to minimize disputes in an unfavorable forum and to promote a uniform approach to enforcement.

Even in jurisdictions hostile to post-employment restrictive covenants, there are sometimes options for companies to retain key employees and minimize the disruption of business caused by resignations. For instance, even in the most hostile jurisdictions, companies may be able to transition to the use of term—as opposed to at-will—employment agreements with key employees that include automatic renewal provisions and strict conditions for early termination. Such provisions inhibit the early departure of term employees and their recruitment by competitors. Companies may be able to use severance agreements or paid leave—or what is often referred to as "garden leave"—agreements for a particular departing employee and where the relevant state law excludes those types of agreements from any statutory ban or limitations that would otherwise apply.

To address jurisdictions with compensation thresholds, companies can consider a form of springing restrictive covenant that expressly is triggered and enforceable only after the relevant statutory compensation threshold is met. This avoids the need of securing a new agreement in connection with a later salary increase or relying on companies' administrative or human resources functions to ensure presentation of new agreements at that later time.

As to procedural notice requirements at the state level, companies must accept that they will be required to provide notice of a post-employment non-compete earlier in the recruiting process than they may have before—and earlier than may be ideal for negotiations. At the high end of the state requirements is an advanced notice period of at least 10 business days prior to the commencement of employment or with the formal offer, whichever is earlier. There are a variety of similar and far shorter periods across the country.

These requirements are significant because, in reality, employment offers in lateral and internal recruiting discussions are often made during the course of negotiations over compensation or other terms unrelated to any restrictive covenant, and they are potentially made even more than 10 business days prior to an individual's start of employment. In the absence of any ability to rely upon a statutory waiver of such notice periods, which is rare among the states, companies can employ standard provisos in agreements that not only notify all employees of their right to consult with independent counsel, but also confirm that the employees have had at least as much time to review the agreements as is required in the most stringent of states.

Adopting this sort of approach may appear simple, but it is not an easy task to change companies' practices so that restrictive covenant obligations are presented earlier during recruiting discussions and sufficiently in advance of the start date. Success requires discipline, and the approach must be ingrained in companies' HR and recruiting functions, as well as with the managers and third-party recruiters leading any discussions with candidates.

While burdensome, that approach also ensures there is a "meeting of the minds" on the terms of the employment prior to the start of a new role, including agreement as to any restrictive covenants, which minimizes future disputes over the parties' intent and also ensures enforceability in some of the states with more strict requirements for notice and execution of restrictive covenant agreements.

And to address those jurisdictions which require notice of restrictive covenant obligations at the termination of employment, companies can modify practices for departing employees to ensure that written reminders of post-employment obligations are timely given. To that end, companies should also consider employing a reciprocal notice obligation through which a departing employee is required not only to inform the company of the employee's resignation a set period of time in advance of termination, but also to notify the company of the employee's anticipated new role and responsibilities.

Companies can also extend that reciprocal notice obligation to apply throughout any post-employment restricted period. Employing such reciprocal notice provisions could provide valuable opportunities for companies to try to fight to retain key employees, to facilitate a successful transition of responsibilities and business, and to try to identify and resolve potential disputes arising out of their future employment opportunities. But compliance does not end there, and those sorts of options may not remain viable forever as this trend continues.

Remaining Vigilant

It is not enough for companies to take one good, hard look at their workforce and their restrictive covenant practices. Companies must accept that this is an ongoing commitment. They must stay abreast of legislative and administrative trends, continue to reassess the need for using specific restrictive covenants, and tailor those restrictive covenants to align with changing business needs.

Part of this ongoing effort should entail active guidance by legal counsel. Companies also ought to consider engaging in open dialogue with state and federal legislators and with relevant federal agencies. Engagement of lobbying groups and participation in hearings and public comment can help companies persuade lawmakers to adopt reasonable, workable solutions that will lessen the burdens those companies will later face.