# PUBLICATION

## Update on Covenants Not to Compete

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Covenants not to compete can be valuable for an employer. But, as in many areas of employment law, non-compete law is always changing. Below are some issues for employers to consider, as well as some recent court developments.

**Know the law in the applicable jurisdiction** (or even better, get assistance from someone who knows the applicable law). This sounds basic, right? Before you get your employee to sign a covenant not to compete, find out about your state's law regarding restrictive covenants. Many states have one or more statutes addressing covenants not to compete, while other states, such as Mississippi, rely on case law. But many states have nuances in this area of the law that are unique and important.

In a recent case in Louisiana, a federal district court refused to enforce the non-compete agreement because the geographical limitations were overly broad and did not comply with the applicable statute, which requires specification of the parishes at issue.[1] In this case, the employee, Hasan Quddus, entered into an employment agreement when he began working for MARiTECH Commercial, Inc. The employment agreement had a non-compete clause which stated that if Quddus elected to terminate this agreement for any reason, then "he shall not perform duties as a marine cargo surveyor in Louisiana, Texas, Mississippi, and Florida for a period of two years from the date this agreement is terminated." Quddus voluntarily terminated his employment in 2012 and went to work for AI Marine Surveyors. MARiTECH filed suit against Quddus and AI Marine seeking to enforce the agreement. The defendants moved to dismiss the claim for breach of the employment agreement. Non-compete agreements are governed by Louisiana Revised Statute § 23:921, which states that contracts or agreements restraining anyone's "lawful profession, trade, or business of any kind ... shall be null and void" unless one of the enumerated statutory exceptions applies. The relevant exception provides:

Any person ... who is employed as an agent, servant, or employee may agree with his employer to refrain from carrying on or engaging in a business similar to that of the employer and/or from soliciting customers of the employer within a specified parish or parishes, municipality or municipalities, or parts thereof, so long as the employer carries on a like business therein, not to exceed a period of two years from termination of employment.

Thus, because the geographical limitations were overly broad and did not comply with the statute, the court held that the non-compete agreement was unenforceable as a matter of law and granted the defendants' motion to dismiss this claim.

**Determine exactly when the employee should sign**. This is really a subtopic of "know the law in your jurisdiction." In a recent case applying Alabama law, the United States Court of Appeals for the 11th Circuit affirmed a judgment denying an employer's motion for preliminary injunction.[2] The district court denied the injunction preventing the former employee, Dawson, from working for his new employer, Millennium, concluding that the non-compete agreement he previously signed was void under Alabama law. The Court held that Dawson signed the agreement "a few days" before he actually began his employment with his former employer, Ameritox, and thus, under the applicable Alabama law, the agreement was void. Under the cases construing Alabama's statute, the exception to the voidness of non-compete agreements does not save such an agreement, *unless the employer-employee relationship exists "at the time the agreement is executed.*"

Because Dawson signed the agreement a few days before his employment began, the court held the agreement was void.

Of course, waiting too long to have an employee sign a non-compete agreement after beginning employment can also be risky. In June, the Kentucky Supreme Court held that a former employee's three-year non-compete agreement was not enforceable when his former employer asked him to sign it after working there for 16 years, and did not give him a raise or a bonus.[3] As these two cases show, it is generally advisable to have the employee sign the non-compete agreement when she or he begins working. Some states take the position that continued employment is sufficient consideration for a covenant not to compete. Other states hold that continued employment is not sufficient without a raise, bonus or other consideration. And many times, it is not a hard and fast rule, but depends on the facts and the equities of the particular case.

**Don't overreach**. Be careful about being overly aggressive in a normal employer/employee covenant not to compete. Before making the geographic prohibition include five different states, you should consider whether the employee actually works or likely will work in all states and whether a court applying the governing law would likely uphold this geographic limitation under the circumstances. Or consider whether a non-solicitation agreement would suffice, which does not prevent the employee from working for a competitor, but could prevent the employee from soliciting clients or other company employees after the employment is terminated.

**Select the governing law**. Most businesses like certainty. Because covenants not to compete are governed by state law, it is a good practice to add a clause about which state's law governs. For small businesses that only operate in one state and only have employees in one state, this is less important, as presumably that state's law will apply. Many businesses have multiple offices and employees doing business with customers in multiple states. Having a governing law or choice-of-law provision that has a reasonable relationship with the employment agreement can save time and money.[4] If you don't select what law applies, you or your attorney might have to conduct a choice of law analysis once your employee leaves to work for a competitor. This can be expensive and often lead to undesirable results.

**Independent contractors v. employees**. As a general rule, covenants not to compete are better suited for employees and should generally not be used for someone who is an independent contractor. If you are considering using a covenant not to compete for an independent contractor, you should consider a few issues. First, as a general rule, you probably can protect trade secrets and other confidential proprietary information that are made available to an independent contractor and really don't need a covenant not to compete. You could get the independent contractor to sign a confidentiality provision or a non-disclosure agreement. This is not absolutely required to protect trade secrets, but is a good idea.

Second, you should consider that if you use a non-compete agreement for someone you designate as an independent contractor, that agreement might later be used to argue that the person is really an employee and not an independent contractor. For instance, as all employers are aware, there has been a surge in wage and hour cases under the Fair Labor Standards Act (FLSA) over the past few years. Many of these cases involve the initial question of whether the plaintiffs are actually employees (and thus covered by the FLSA) or independent contractors. Many courts have held that a non-compete agreement will generally weigh towards a finding that he or she is an employee and not an independent contractor. It may just be one factor among many, but it might be enough to create a fact question and send the case to trial. As one court held: "[defendant] cannot have it both ways: that is, she cannot claim that her maids are independent contractors, who would traditionally be free to use their skills wherever they please, and simultaneously prevent them from working for other maid services in the Chicagoland area."[5]

**Conclusion.** Again, this is an area of law that is constantly evolving and can be fact sensitive. Courts construing covenants not to compete often consider the equities of the present situation, including the interests

of the employer, the employee and sometimes, the public. A lot can depend on the jurisdiction, industry, technology used, education and the income of the employee. Employers who use non-competes and non-solicitation agreements should periodically review their agreements based on recent legal developments.

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[1] *Maritech Commercial, Inc. v. Quddus,* NO. CIV.A. 13-0613, 2014 WL 2624944, (E.D. La. Jun 12, 2014).

[2] *Dawson v. Ameritox, Ltd*., --- Fed. Appx. ----, 2014 WL 3361169 (11th Cir. Jul 10, 2014).

[3] *Charles T. Creech, Inc. v. Brown*, 433 S.W.3d 345 (Ky. 2014).

[4] *See e.g. Atlantic Diving Supply, Inc. v. Moses*, NO. 2:14CV380, 2014 WL 3783343 (E.D. Va., Jul 31, 2014) (where federal district court in Virginia applied Delaware law, based on choice-of-law provision in agreement and granted former employer's motion for preliminary injunction based on non-solicitation agreement).

[5] *Swinney v. AMcomm Telecomm., Inc*., NO. 12-12925, 2014 WL 2864805, (E.D. Mich. Jun 24, 2014) ("The Court further notes that the independent contractor agreement contains a non-compete agreement, which in and of itself weighs in favor of viewing Plaintiffs as employees.")