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Top 10 Mistakes Employers Make with Non-Compete and Confidentiality Agreements

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Who cares?

- Perhaps you rarely touch non-competes, non-solicits, and confidentiality agreements—maybe only when onboarding new employees
- Perhaps you rarely encounter disputes over those agreements
- Who knows if those agreements are actually effective—employees will do whatever they want to do, right?

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Who cares now?

- Your VP of Sales left and joined your main competitor, possibly taking along confidential customer and pricing information.
- An employee who left your company is now recruiting other employees to leave and join another company.
- You just received a lawyer letter that accuses your new hire of violating a non-compete and threatens immediate litigation.

1. No non-compete when you should have one

- You can't enforce a non-compete than you don't have
- Do you need a non-compete?
  - Not necessary for every employee
  - Most important for employees who have access to customer relationships, confidential information, or trade secrets
  - Assess based on employee roles/categories
- Protectable interests
  - Customer relationships
  - Confidential information

1. No non-compete when you should have one

- Non-protectable interests
  - Retaining employees
  - Punishing disloyal employees for leaving
  - Preventing competitors from benefiting from your former employees' skills and abilities
- Ask: If this employee left and joined a competitor, would that be a problem?
  - If so, why? Does the answer involve confidential information or customer relationships?

2, 3, and 4. No enforceable non-compete

- An unenforceable non-compete is almost as bad as no non-compete
  - While it may affect some employee/former employee behavior, it will not stand up if push comes to shove
- How do unenforceable non-competes come about?
- Let's count (a few of) the ways

2. No consideration

- A non-compete must be supported by consideration—some benefit the employee receives for entering into the non-compete
- In some states, including NC, continued employment is not adequate consideration
- "Sign the non-compete or you're finished here" doesn't cut it
- An employer must provide something more: a raise, a promotion, a bonus, or something else of value
- The consideration must also be contingent on the employee agreeing to the non-compete—if the employee would receive the consideration either way, it cannot support the non-compete

2. No consideration

- New employment can serve as consideration, but in states like NC, the non-compete must be part of what the parties agree on when the employee was hired
- Having a new employee sign a non-compete after they have begun work only suffices if the non-compete was part of the original agreement or the employer provides some additional consideration
  - Mention the non-compete in the offer letter
  - Have the employee execute it with first-day paperwork
- Ask: What would this employee receive in return for agreeing to the non-compete?

3. Overbroad in scope

- Non-competes are disfavored
- Courts balance the employer's right to protect its legitimate interests against the hardship on the employee
- Courts will strike down and refuse to enforce non-competes that are overbroad in scope
- In some states, including NC, courts will not attempt to rewrite an overbroad non-compete to be more reasonable

3. Overbroad in scope

- Must be reasonable in time (length of time) and territory (geographic area)
- Must be tailored to protect the employer's legitimate interests
- Three common pitfalls:
  - Prohibiting any type of employment with a competing business (the "janitor problem")
  - Prohibiting competing "directly or indirectly" with the employer
  - Prohibiting competing with the employer or its "affiliates"

4. Overbroad customer restrictions

- A non-compete can be based on customers instead of geography
- In NC, a customer-based restriction should be tied to the customers with whom the employee had actual business contact
- Broad prohibitions that are based on all of the employer's customers are problematic
- Tie the restriction to the customers that the employee actually had contact with during their employment

5. Assuming that different states treat non-competes the same

- There are enormous differences between states on non-compete law
  - Non-competes are prohibited in CA, ND, and OK
  - States differ wildly on what types of restriction are enforceable
  - State courts have very different approaches to handling non-compete litigation
- Non-compete law is in flux now more than ever
  - Pending legislation in a number of states
  - Rumblings about potential federal regulation by the FTC

5. Assuming that different states treat non-competes the same

- What does this mean?
  - Don't assume that a non-compete form that was drafted for one state will work well (or at all) in another state
  - Don't assume that a time-tested form is timeless
  - Think about choice of law and choice of forum provisions

6. No confidentiality agreement ("But's it in the handbook!")

- Handbook confidentiality provisions are not confidentiality agreements
- In general, you do not want your employee handbook to be considered a contract
- Have a separate confidentiality agreement, either as a standalone agreement or within a broader employment agreement or restrictive covenants agreement
- Confidentiality agreements are not disfavored the way that non-competes are

7. No carveout for protected activity

- A confidentiality agreement should include a carveout that allows an employee or contractor to engage in protected activity without violating the agreement
- To preserve the opportunity to recover exemplary damages and attorneys' fees under the Defend Trade Secrets Act, a company must provide specific notice to the employee or contractor about their right to disclose trade secret information

7. No carveout for protected activity

- Sample notice: Notwithstanding any other provision of this Agreement, [Employee/Contractor] will not be held criminally or civilly liable under any federal or state trade secret law for the disclosure of a trade secret that is made (i) in confidence to a federal, state, or local government official, either directly or indirectly, or to an attorney and (ii) solely for the purpose of reporting or investigating a suspected violation of law, or that is made in a complaint or other document that is filed under seal in a lawsuit or other proceeding; and in the event that [Employee/Contractor] files a lawsuit for retaliation by the Company for reporting a suspected violation of law, [Employee/Contractor] may disclose the Company's trade secrets to [Employee's/Contractor's] attorney and use the trade secret information in the court proceeding if [Employee/Contractor] files each document containing the trade secret under seal and does not disclose the trade secret, except pursuant to court order.

8. Lack of trade secret protections

- What is a trade secret?
- NC law: A trade secret is "business or technical information" that "[d]erives independent actual or potential commercial value from not being generally known or readily ascertainable through independent development or reverse engineering" and is "**the subject of efforts that are reasonable under the circumstances to maintain its secrecy**." N.C. Gen. Stat. § 66-152(3).
- Federal law: Trade secrets are "all forms and types of financial, business, scientific, technical, economic, or engineering information" for which "the owner thereof has taken **reasonable measures to keep such information secret**" and "the information derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable through proper means by, another person who can obtain economic value from the disclosure or use of the information." 18 U.S.C. § 1839(3).

8. Lack of trade secret protections

- Reasonable efforts/measures are necessary to maintain trade secret status
- What are reasonable measures to maintain secrecy?
  - Confidentiality agreements with employees
  - Confidentiality agreements with contractors, vendors, and suppliers
  - Need-to-know access
  - Other physical, electronic, and procedural safeguards

9. Inadequate onboarding

- Confirm the employee has no non-compete/non-solicit obligations to prior employers
- Confirm no confidentiality agreements or other agreements with prior employers
- Review any agreements
- Instruct the employee not to bring or use any confidential information or trade secrets from prior employers
- Document the responses

10. Inadequate exit interview

- Remind the employee of their non-compete, non-solicit, and confidentiality obligations and provide copies of the relevant agreements
- Ask them where they are going and what they will be doing
- Ask them if they have (or have taken) any company documents or information
- Document their responses
- Talk to their managers to learn more about their future plans and ensure consistent messaging

11. Waiting to address potential problems

- When non-compete, non-solicit, confidentiality, or trade secret issues arise, don't wait
- Litigation over these issues moves quickly, since the goal is often to obtain emergency relief from the court
- Delay makes it more difficult to show that emergency relief is necessary or would be appropriate, and by the time you obtain that relief, the damage may be done
- Trust your instincts and be proactive—ask, document, investigate, and call your lawyer if needed

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