

## FOLEY EXECUTIVE BRIEFING SERIES



### Drafting Enforceable Non-Compete Agreements June 10, 2008

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## FOLEY EXECUTIVE BRIEFING SERIES

### Basic Considerations

#### Protectible Interest/Rule of Reason Analysis

- How Courts/Juries View Non-Competes
- One Size Does Not Fit All
  - State/Jurisdiction Specific (DC, VA, MD)
  - Industry Specific (Internet business v. bricks & mortar)
  - Activity Specific (R&D v. salespersons)

This presentation does not convey the complexity of the laws of each state/jurisdiction. You should always do a “reality check” and research the actual case law of each state/jurisdiction. Other factors can also affect the analysis.



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## Protectible Interest

- Protectible Interest/Rule of Reason Approach
  - Is the restraint reasonably limited in terms of:
    - Time
    - Territory or market
    - Activity
  - Look at the employee's duties, location(s) and other relevant items (e.g., customer cycle). Be able to show reasonableness.
- Courts will generally go back to this element when assessing the reasonableness of a non-compete.



## Drafting Considerations

- Definition of Business
  - Is it specific?
  - Will someone be able to determine what the company does from the document?
  - Does it contain dangerous "catch-alls?"
    - "Any business in which **[the Company/Employee on the Company's behalf]** is engaged..."
- Customer-Based Restrictions
  - Prospective (Identified?) v. Actual.
  - Geographic limitation required?



## Drafting Considerations

- After-thought covenants
  - Additional consideration required?
  - Employee Transfers and/or Promotions (Massachusetts Example).
  - **Example:** *The parties acknowledge Employee's existing employment with the Company, and, upon the effectiveness of this Agreement, the parties wish to replace all prior employment agreements between the parties, including the Employment and Non-Compete Agreement, dated as of \_\_\_\_\_, 2008, between Employee and the Company, with this Agreement, which is executed in connection with Employee's promotion and an increase in Employee's compensation.*



## Drafting Considerations

- Effect of Employer Termination of Employee
  - Breach
  - Cause v. without cause
- Jury Trial Waivers
  - Probably a good idea if they are enforced.
  - Be Very Careful.



## Drafting Considerations

- Right to an Injunction/Equitable Relief
  - Seek v. obtain.
  - **Example:** *Since a material purpose of this Agreement is to protect the Company's investment in Employee and to secure the benefits of Employee's background and general experience in the industry, the parties hereto agree and acknowledge that money damages [may/will] not be an adequate remedy for any breach of the provisions of this Section \_ [Non-Compete Section] and that any such breach [may/will] cause the Company irreparable harm. Therefore, in the event of a breach by Employee of any of the provisions of this Section \_ [Non-Compete Section], the Company or its successors or assigns shall be entitled to [seek] specific performance and/or injunctive or other relief in order to enforce or prevent any violations of the provisions of this Agreement. Such relief shall be in addition to other rights and remedies existing in the Company's favor [and shall be granted without the posting of a bond or other security and without proof of actual damages].*



## Drafting Considerations

- State Law
  - Where the employee lives or works; not Delaware.
  - Public policy argument.
- Forum Selection Clauses
  - An important consideration depending on the hardship to the employee.
  - Beware of the public policy argument.
  - **Example:** *Employee hereby agrees that any claim or action regarding or relating to this Agreement shall be subject to the exclusive jurisdiction of the state courts of the [State/Commonwealth/District] of \_\_\_\_\_ or the federal district court for the \_\_\_\_\_ District of \_\_\_\_\_ and Employee hereby submits to the exclusive jurisdiction of said courts.*



## Drafting Considerations

- Alternative Dispute Resolution Clauses
  - Good or bad for enforcing non-competes?
  - Current Issues regarding arbitration.
  - **Example 1:** *All disputes under this Agreement shall be submitted to and governed by binding arbitration with an arbitrator from the American Arbitration Association; except only that the Company may seek relief in a court of competent jurisdiction in the event of a claimed violation of Section \_ [Non-Compete Section] or Section \_ [Confidentiality/Inventions Section] of this Agreement.*
- DO NOT USE IN CALIFORNIA



## Drafting Considerations

- **Example 2:** *Arbitration Agreement. All disputes involving the application, interpretation or enforcement of this Agreement shall be submitted to and governed by binding arbitration with an arbitrator from the American Arbitration Association ("AAA"); except that the Company and Employee may seek relief in a court of competent jurisdiction in the event of a claimed violation or improper use of Section \_ [Non-Compete Section] or Section \_ [Confidentiality/Inventions Section] of this Agreement. Except with respect to any claimed violation or improper use of Section \_ [Non-Compete Section] or Section \_ [Confidentiality/Inventions Section], neither the Company nor Employee may invoke arbitration more than ninety (90) days after the invoking party knows, or should have known, sufficient information to give that party an understanding that the parties have reached an impasse on their respective positions regarding the application, interpretation or enforcement of any provision of this Agreement. Failure to invoke arbitration within that ninety (90) day period shall constitute a waiver of any such right. If either party invokes arbitration, the Company shall pay the initial AAA file-opening charge, and fees and costs shall be awarded in conformance with the applicable AAA rules.*
- The AAA rules can be found at [www.adr.org](http://www.adr.org).



## Drafting Considerations

- Not Necessarily a Perfect Solution – Check with local counsel
- Assignment
  - Stock v. asset deals.
  - **Example:** *This Agreement is intended to bind and inure to the benefit of and be enforceable by Employee and the Company, and their respective successors and assigns. Employee may not assign Employee's rights or delegate Employee's obligations hereunder without the prior written consent of the Company. The Company may assign its rights and delegate its duties hereunder without the consent of Employee to Permitted Transferees.*



## Drafting Considerations

- Statement that the Agreement is reasonable and not unduly harsh or oppressive
  - Reference to other gainful employment opportunities
  - **Example 1 (Broad Territory):**
    - *Employee agrees that the restraint imposed under this paragraph \_\_\_ is reasonable and not unduly harsh or oppressive and that, in the event that Employee is subject to the Non-Compete following the Employment Period, Employee would be able to find gainful employment within the Restricted Territory in the general field of \_\_\_\_\_, without providing the highly specialized \_\_\_\_\_ services and products that Employee is prohibited from providing during the Non-Compete Period.*
      - See long version in attached materials.
  - **Example 2 (Local Sales Route).**
    - See example in attached materials



## Drafting Considerations

- Legal Effect/Attorney Review
  - Typeface, location in document. Make sure it is conspicuous.
  - **Example:** *Employee Acknowledgement.* *Employee acknowledges and agrees that Employee has been given ample time and fair opportunity to review this Agreement, to ask any questions Employee might have, to consult with an attorney or other professional and to suggest alternative provisions. Employee further states that Employee understands the meaning and import of the terms and provisions of this Agreement, that the Company has not unfairly or unduly influenced Employee to sign this Agreement and that Employee willingly and voluntarily enters into this Agreement as a condition of Employee's employment and for fair and reasonable consideration.*



## Drafting Considerations

- Reformation and the Blue Pencil Doctrine - Three General Theories
  - All or Nothing
    - If the non-compete is a little overbroad, the whole non-compete is declared unenforceable.
  - Blue Penciling
    - The court deletes grammatically severable provisions only.
    - What does this mean?
  - Reformation
    - The court exercises broad powers to make the non-compete reasonable.



## Drafting Considerations

- State/Jurisdiction Differences
  - Modification and Severability Examples
- **Example 1 (Modification):** *If, at the time of enforcement of any provision of Section \_ [Non-Compete Section], a court or arbitrator holds that the restrictions stated therein are unreasonable or unenforceable under circumstances then existing, the Company and Employee agree that the maximum period, scope or geographical area reasonable or permissible under such circumstances will be substituted for the stated period, scope or area.*



## Drafting Considerations

- **Example 2 (Severability):** *The parties agree that (i) the provisions of this Agreement shall be severable in the event that any of the provisions hereof are for any reason whatsoever invalid, void or otherwise unenforceable, (ii) such invalid, void or otherwise unenforceable provisions shall be automatically replaced by other provisions which are as similar as possible in terms to such invalid, void or otherwise unenforceable provisions but are valid and enforceable and (iii) the remaining provisions shall remain enforceable to the fullest extent permitted by law.*



## Drafting Considerations

- Step-down Clauses: Are they worth the risk?
  - **Example:** *If, at the time of enforcement of any provision of Section \_ [Non-Compete Section], a court or arbitrator holds that the restrictions stated therein are unreasonable or unenforceable under circumstances then existing, the Company and Employee agree that the maximum period, scope or geographical area reasonable or permissible under such circumstances shall be as follows: (1) the “Non-Compete Period” shall be amended by substituting the phrase “six (6) months” for “one (1) year” in Section \_ [Non-Compete Section]; and (2) the geographic restriction shall be amended by substituting “thirty (30) mile radius” for “fifty (50) mile radius” in Section \_ [Non-Compete Section], and, if the court or arbitrator finds “thirty (30) mile radius” to be unreasonable or unenforceable, “ten (10) mile radius” shall be substituted therefore.*



## General Guidelines

- State/Jurisdiction Differences (DC, VA, MD)
  - Time
    - Employment
    - Sale of Business
  - Geography
    - Employment
    - Sale of Business
  - Reformation/Blue-Pencil Doctrine



## General Guidelines

- VA – “employee of...”
  - “where Employee’s position and/or services involve or require the performance of duties substantially similar to those Employee performed for the Company”
  - “with a view toward offering or providing Competitive Services to such Company Customer or to the customers of such Company Referral Source”
- Stay away from gender-specific pronouns.
- Remember that one size does not fit all!



## Interplay between Geography and Business

- Examples (Assume confidentiality provisions, reformation, savings and severability clauses and right to seek an injunction provisions are included):
  - Expansive geographic scope/narrow business description.
  - Limited geographic scope/general description of business.
  - Look at the definition/description of business.



## Interplay between Geography and Business

- Look at the maximum geographic scope if the locations are based on where an individual works (Connecticut).
- If an arbitration clause, is the right to seek an injunction for violation of non-compete/confidentiality included?
- No right answer – always come back to the protectible interest/rule of reason.



## Contact Information

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