Drafting Restrictive Covenants That Work – Insights from Recent Legal Battles

2025 Trade Secrets Webinar Series

February 27, 2025

Seyfarth Shaw LLP

Legal Disclaimer

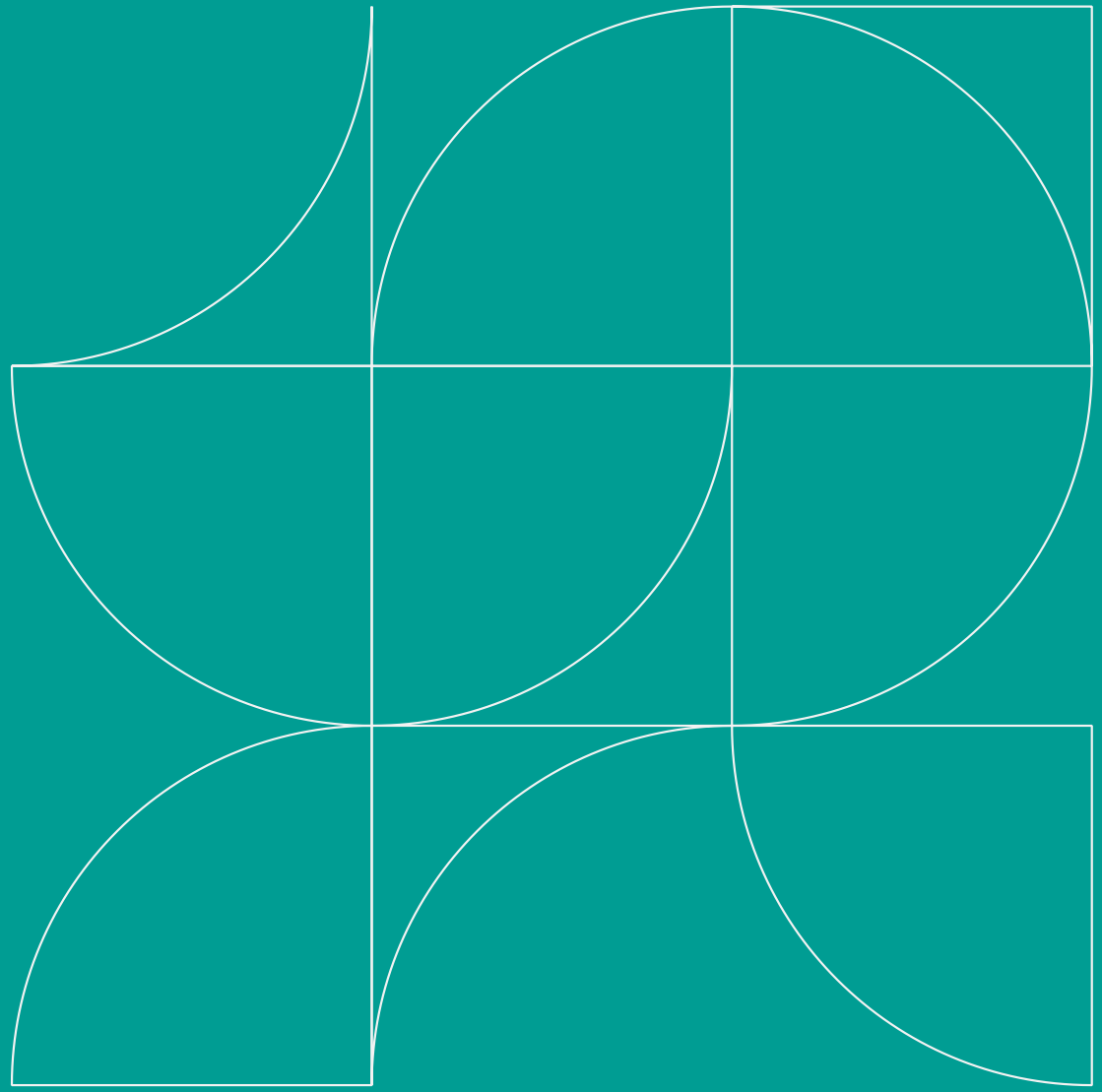
This presentation has been prepared by Seyfarth Shaw LLP for informational purposes only. The material discussed during this webinar should not be construed as legal advice or a legal opinion on any specific facts or circumstances. The content is intended for general information purposes only, and you are urged to consult a lawyer concerning your own situation and any specific legal questions you may have.

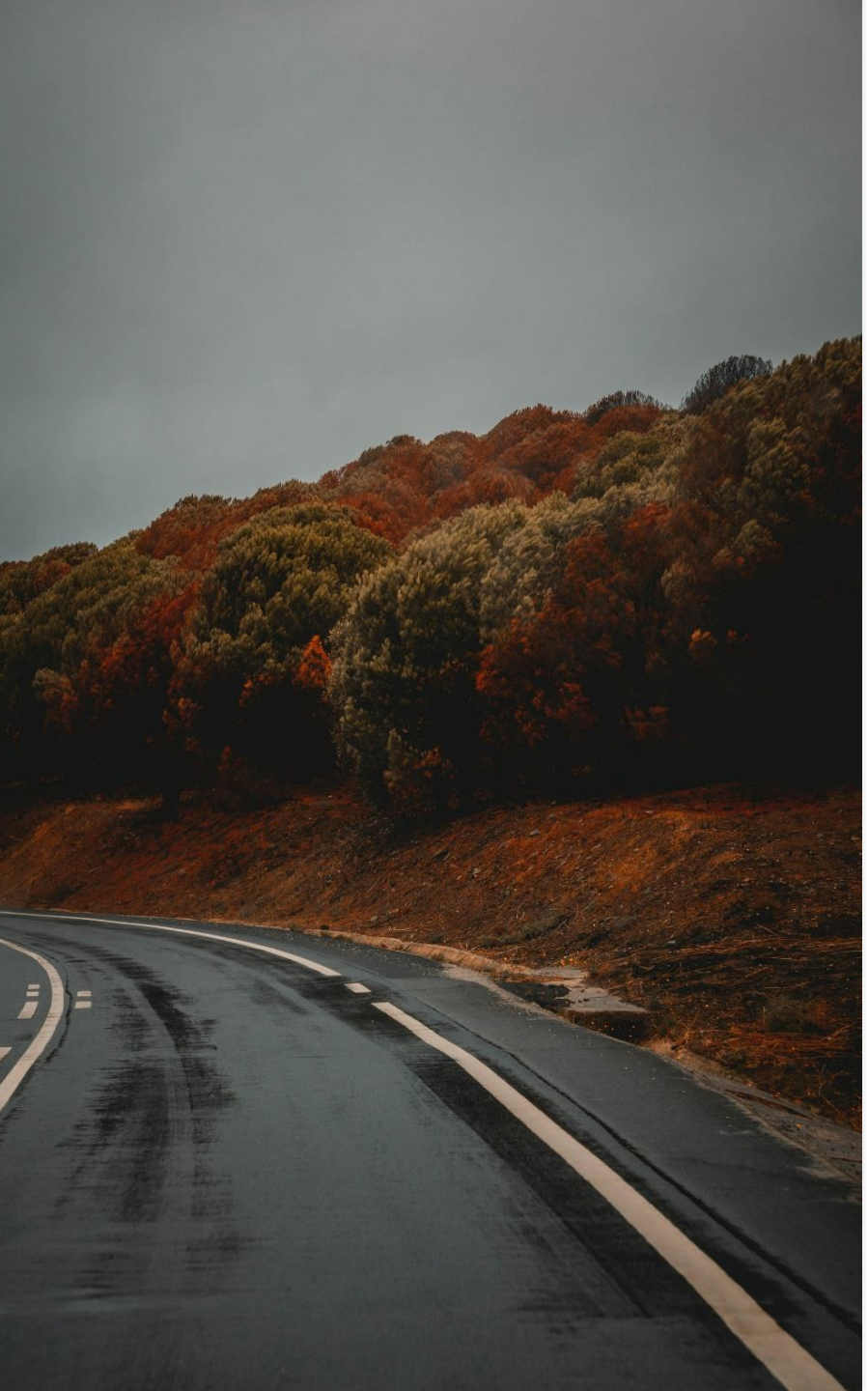
Speakers

Dawn Mertineit
Partner
Boston

Dallin Wilson
Partner
Boston

Introduction & Overview





Agenda

1 | The Current Landscape for Restrictive Covenants

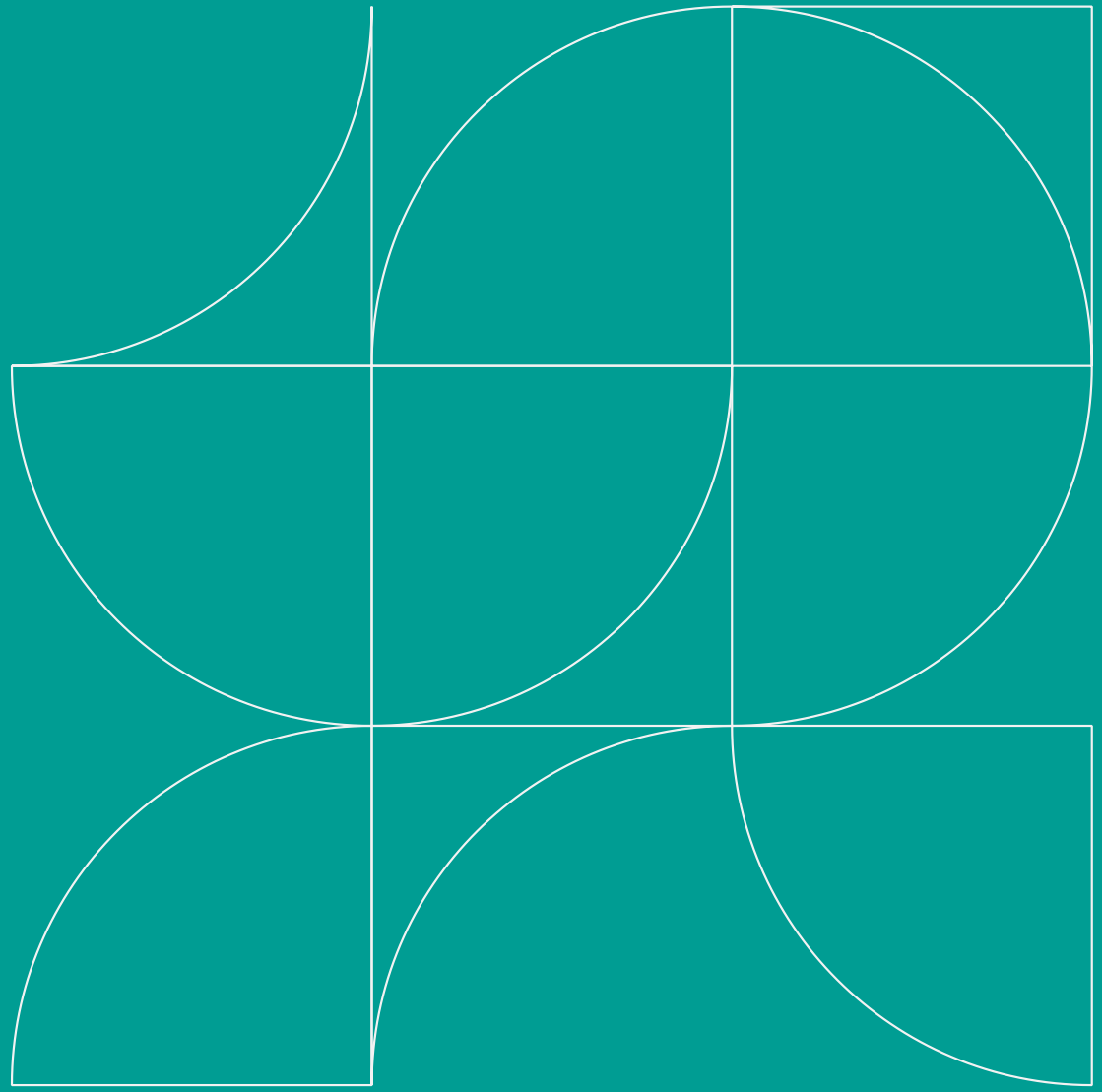
2 | Changes in Caselaw

3 | Beyond the Non-Compete

4 | FTC/NLRB Update

5 | Drafting Covenants that Work

The Current Landscape for Restrictive Covenants



Statutory Requirements

50 states plus D.C., plus local requirements = a patchwork of statutory and common law requirements

Some Common Themes for Statutory Requirements

- Wage thresholds
- Forum selection limitations
- Choice of law limitations
- Notice requirements
- Presumptions of reasonableness/unreasonableness (duration, scope, etc.)
- Right to counsel provisions
- Penalties for failure to comply with requirements, including fee-shifting
- Bans or strict limits on restrictive covenants in healthcare
- Bans on virtually *all* non-competes (CA, OK, ND, MN)

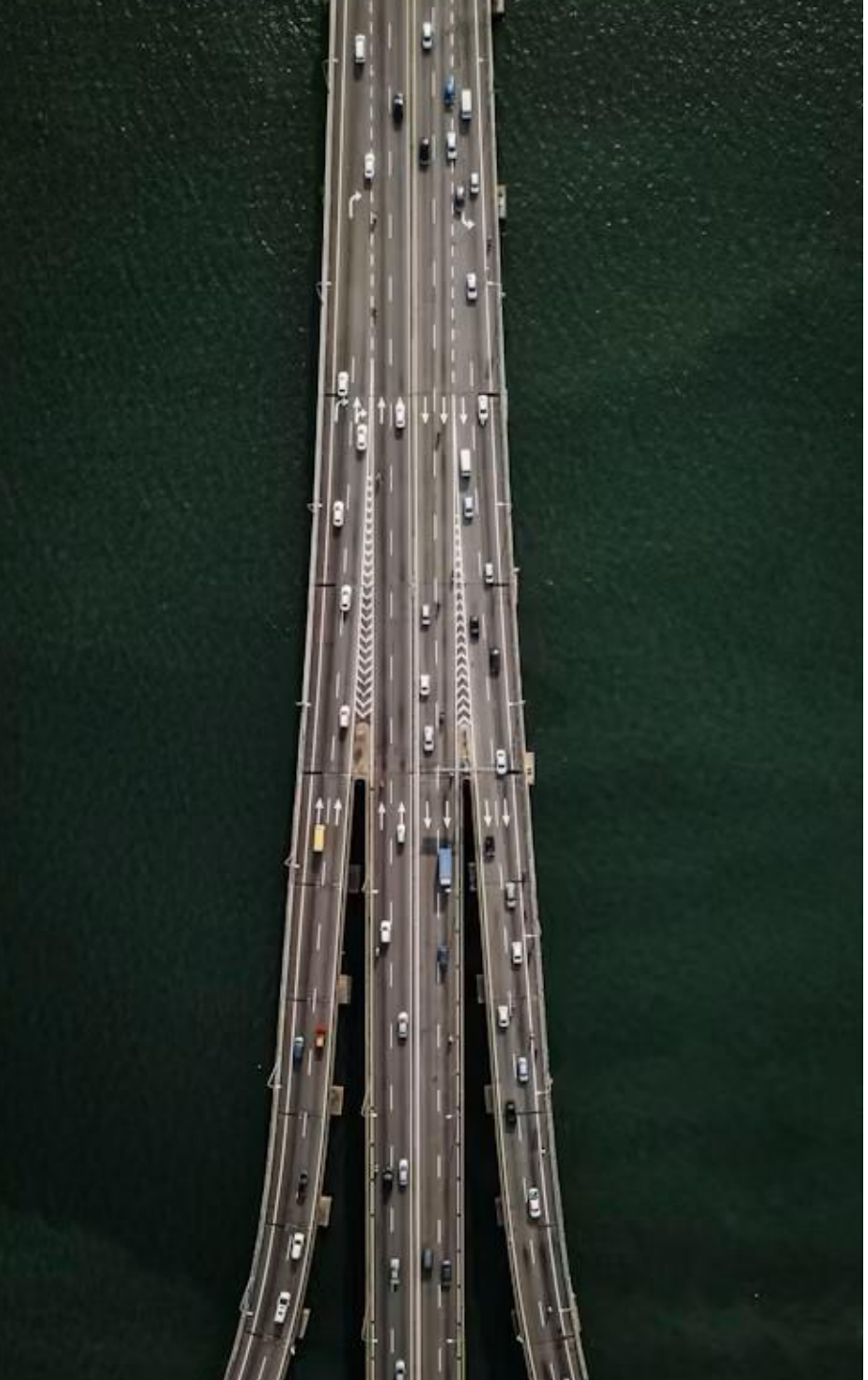
Other State-Specific Rules (Statutory or Otherwise)

Other state-specific considerations:

- Continued employment vs. new consideration
- What is sufficient consideration?
- Blue penciling vs. reformation (or neither)
- Enforceability against discharged employees?
- Extension of restricted period for breach?

Examples of outlier states

- **Alabama**
  - Only sign once officially employed
- **California**
  - Virtually all non-competes *and* customer non-solicits void
  - Employee non-solicits most likely void
  - Requirement to provide notice of void provisions
- **Colorado**
  - Separate, standalone notice
- **Louisiana**
  - Identification of parishes
  - Only sign once officially employed



Examples of outlier states (cont'd)

- **Maine**
  - Delay for enforceability of non-compete
- **Massachusetts**
  - Material change doctrine
- **Oregon**
  - Must provide copy of agreement w/in 30 days of termination
- **Washington**
  - Retroactivity of new, strict rules
  - Non-compete definition now includes non-acceptance of business clauses
- **Various states (D.C., Virginia):**
  - Statutory language posted or included in the agreement

Venue and Choice of Law Provisions

You can no longer rely on venue and choice of law provisions where the employer is located and/or incorporated.

State-specific statutes increasingly prohibit requiring employees to litigate outside of their home state:

- **California** - California Business and Professions Code Section 16600.5 (any non-compete void under CA law is unenforceable regardless of where and when the contract was signed)
- **Washington** – Chapter 49.62.050 (non-compete is void and unenforceable if it contains non-WA venue or choice of law)
- **Massachusetts** – M.G.L. c. 149, §24L (choice of law that would avoid requirements of MA law ineffective if the employee resides or works in MA at termination)
- **Minnesota** – M.S.A. § 181.988(3) (a foreign forum or choice of law that deprives the employee of protections of MN law voidable; fee-shifting available to employee)
- **Louisiana** – R.S. 23:921 (foreign choice of law/forum void unless knowingly agreed to and ratified by the employee)

Employer's Home vs. Employee's Home

Will Courts Honor Choice of Law or Venue Provisions That Violate Other States' Law?

- Conflicts of laws: how do decide which choice of law or venue will apply when the agreement contains provisions that may violate laws in the employee's home state?
- Most states will apply contractual choice of law provisions unless either (a) the chosen state "has no substantial relationship to the parties or the transaction and there is no reasonable basis for the parties' choice"; or (b) application of the law of the chosen state "would be contrary to a fundamental policy" of a state which "has a materially greater interest than the chosen state in the determination of the particular issue."
- "No substantial relationship" test is easy to meet
- "Materially greater interest" test is trickier.

Does California Have a "Materially Greater Interest" in Enforcement of Non-Competes Than Other States That Permit Them?

- With more and more states passing legislation limiting enforcement of non-competes (including outright bans), employees have argued that application of the law of their employers' states would be contrary to a fundamental policy of their home state.
- But does their home state have a "materially greater" interest than their employers' home state?

Jurisdictional Issues

DraftKings v. Hermalyn: A Race to the Courthouse (and to California)

- In *DraftKings*, the First Circuit started its opinion with the following line: “Massachusetts and California aren't exactly on the same page when it comes to noncompete agreements.”
- DraftKings (based in MA) employed Hermalyn (who lived in NJ). Hermalyn quit to take a similar job with a competitor in California. DraftKings sought to enforce Hermalyn’s noncompete, which had a MA choice of law provision.
- Hermalyn argued that because he had moved to CA, CA had a “materially greater interest” than MA in the enforcement of his noncompete.
- The First Circuit disagreed, holding that Hermalyn had failed to show that CA had a materially greater interest than MA where MA has its own noncompete statute and where Hermalyn had only recently moved to CA.

What Law Should Govern Employees' Non-Competes?

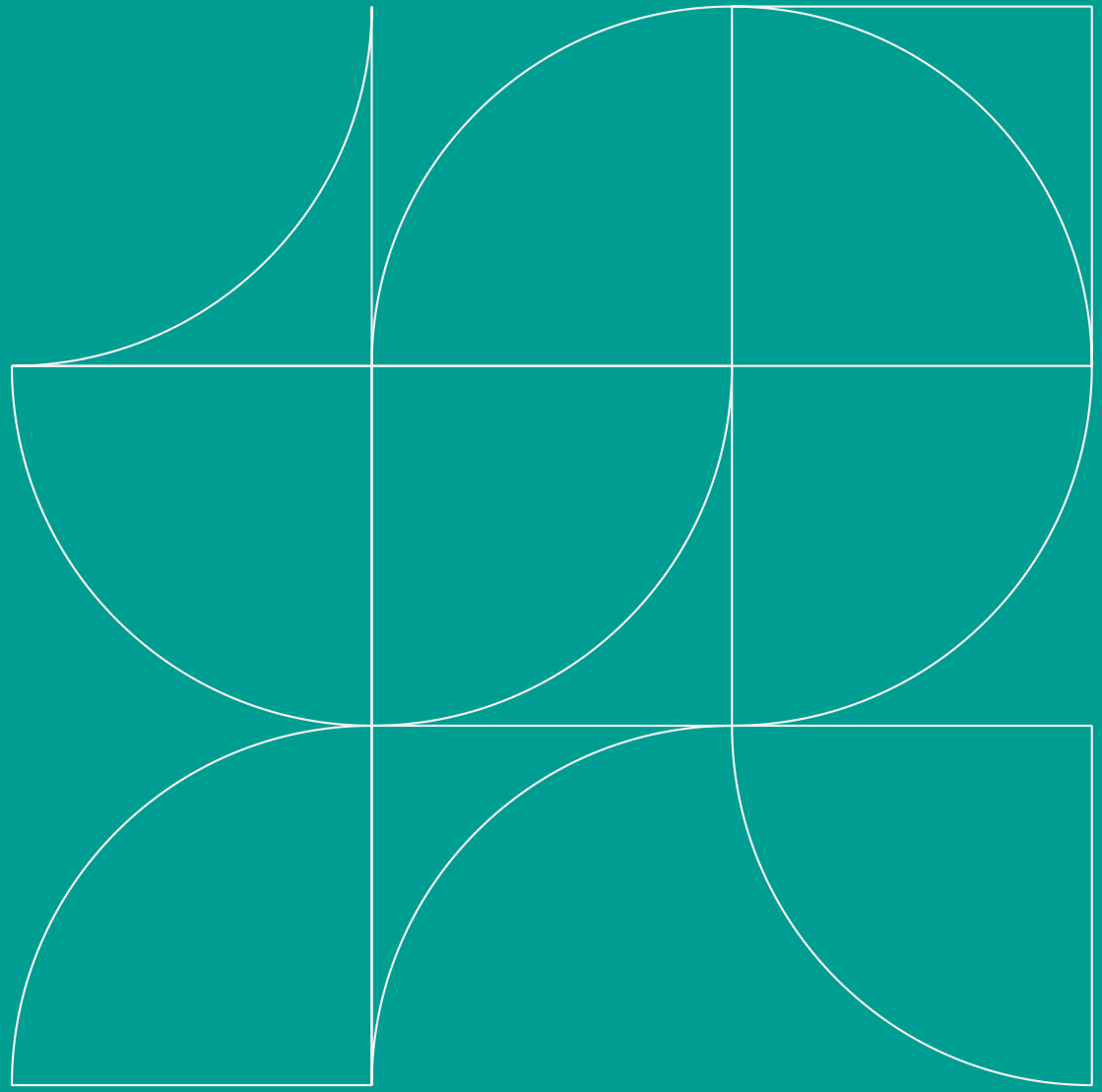
If employee resides in a state that outlaws out-of-state venue and choice of law provisions, employers take on risk that provisions will be deemed unenforceable (and in CA, MN, and WA, can lead to separate civil liability to employee).

- Employee's state courts likely to invalidate out-of-state choice of law, but if the employer files first, out-of-state court may uphold provision.

If employee resides in other states, agreements can contain choice of law provision, so long as employer can show that the state has a "substantial relationship" to the parties (usually principal place of business or state of incorporation)

- Because many corporations are incorporated in DE, it is common for employment agreements to have DE choice of law. Consider whether DE continues to be a favorable forum for employers?

Changes in Caselaw



Non-Legislative Changes

- It’s not just legislation or agency rules/guidance that change the landscape…
- Some notable examples of changes from key cases:
  - **Georgia:** GA Supreme Court held in September 2024 that restrictive covenants are not required to contain express geographical limitations to be enforceable; geographic scope must be assessed for reasonableness “in light of the totality of the circumstances including, but not limited to, the total geographic area encompassed by the provision, the business interests justifying the restrictive covenant, the nature of the business involved, and the time and scope limitations of the covenant.”
    - Nationwide and worldwide restrictions becoming more acceptable

Non-Legislative Changes

Delaware: trending away from blue-penciling. Starting with the October 2022 decision in *Kodiak Building Partners, LLC v. Adams*, where the Delaware Chancery Court refused to blue pencil (and enforce) a sale-of-business noncompete, Delaware courts have increasingly refused to blue pencil non-competes they find overbroad.

- *Centurion Serv. Grp., LLC v. Wilensky*: two-year nationwide non-compete held to be overbroad – refused to blue pencil
- *Sunder Energy, LLC v. Jackson*: refusing to blue pencil overbroad and unreasonable non-compete, finding that doing so would create a "no-lose situation" for employers that incentivizes drafting overboard restrictions
- *Hub Grp., Inc. v. Knoll*: refusing to blue pencil because "that would encourage the use of overboard non-competes; with some fraction of employees cowed into accepting unenforceably broad restrictions

A Word About Forfeitures and Clawbacks

- Some states follow the “employee choice” doctrine (i.e., NY, TX, DE). Others do not.
- For example, in MA, forfeiture for competition agreements are analyzed under the same reasonableness framework as non-competes. The same is true in CT, MD, and PA.
- In ND, forfeiture for competition agreements are *per se* unenforceable.
- In states where forfeiture for competition agreements are not judged for reasonableness, employers may want to consider whether a forfeiture for competition agreement acts as a stronger deterrent to an employee considering violating a noncompete.

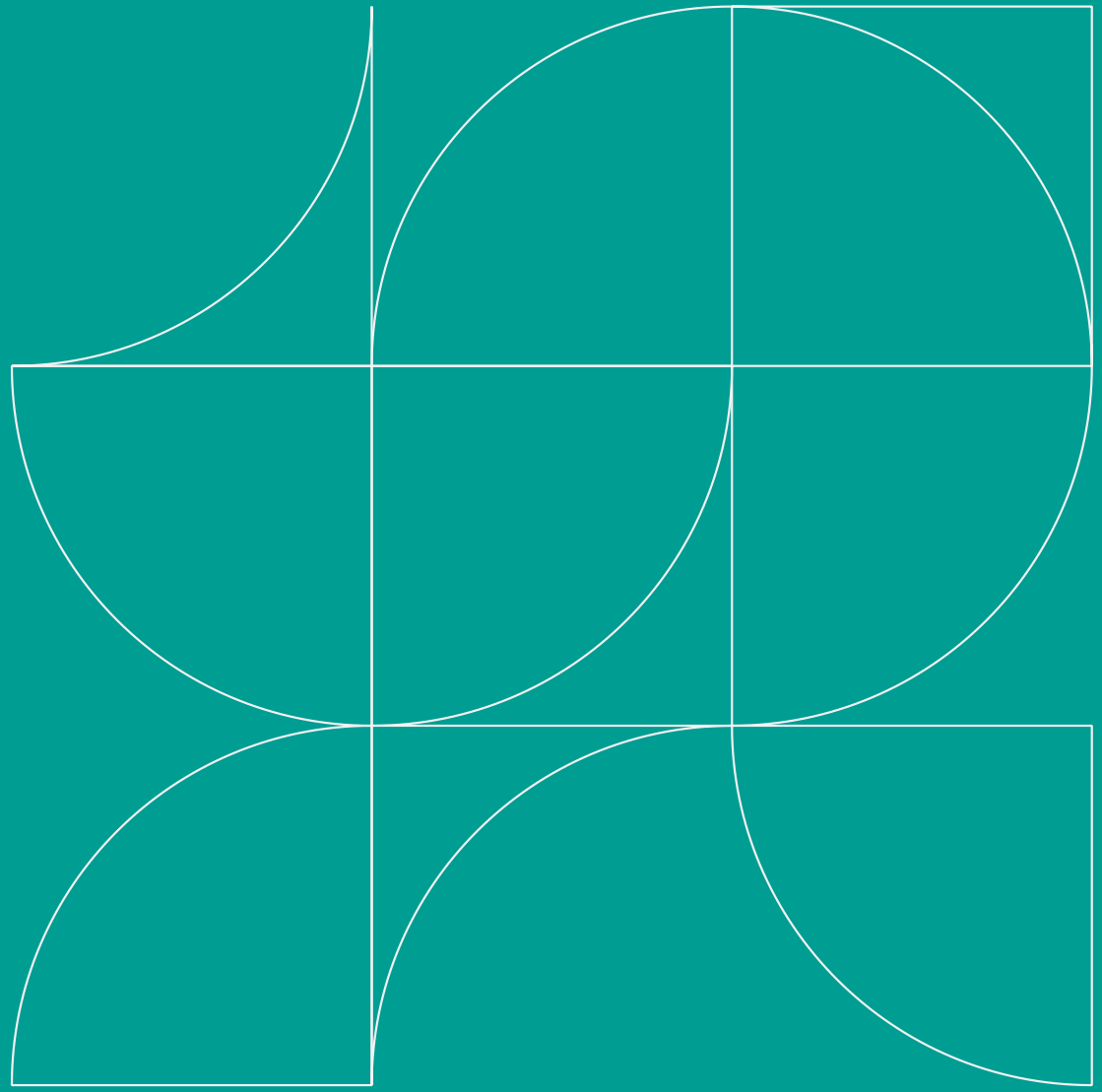
Employee Choice Doctrine Affirmed in Delaware

- At the beginning of 2024, the Delaware Supreme Court reaffirmed the validity of forfeiture-for-competition provisions in *Cantor Fitzgerald, L.P. v. Ainslie*, a case involving partners bound by high-level partnership agreements forfeiture-for-competition provisions — through which a contracting party agrees to give up or forfeit financial benefits if they later compete for a specified period of time — are not subject to the more exacting "rule of reason" analysis but rather the "employee choice doctrine," which treats forfeiture for competition agreements like regular contracts.
- Then in December 2024, the Delaware Supreme Court in *LKQ Corp. v. Rutledge* held that the employee choice doctrine applies to a range of agreements, including stock award agreements with middle managers or lower-level employees. The court reasoned that forfeiture for competition provisions do not restrict a former employee's ability to work.

Forfeiture Agreement or Noncompete?

- Employers incorporated in Delaware should consider whether forfeiture for competition agreements provide a stronger disincentive to prevent employees from breaching restrictive covenant agreements, particularly where employees risk forfeiting significant payments.
- However, courts have consistently held that employers are not entitled to injunctive relief to prohibit former employees from competing where the agreement contains a forfeiture for competition clause; the only remedy is clawing back the money.

Beyond the Non-Compete



Non-Solicits and Confidentiality Provisions At Risk Too

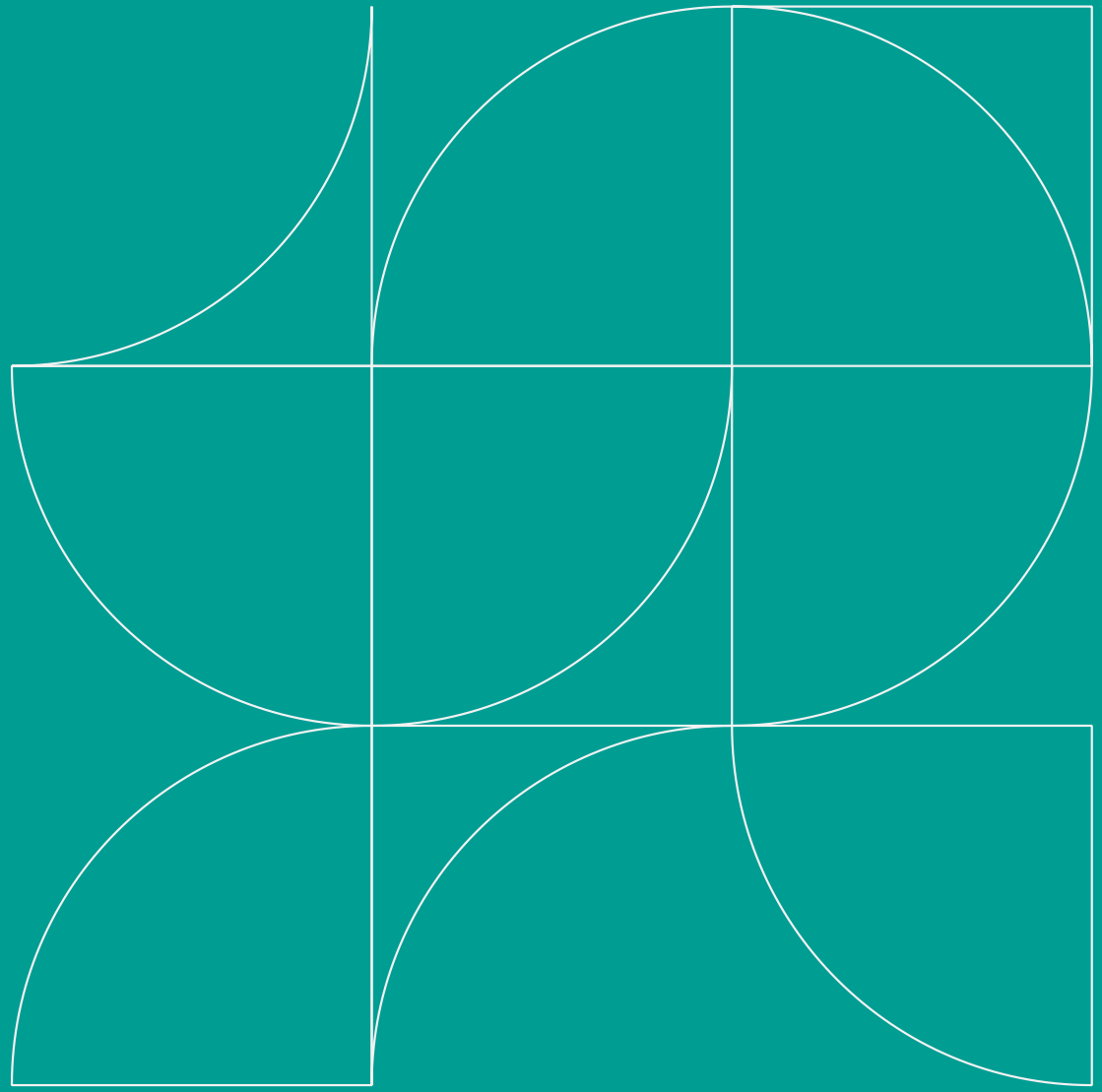
States with limitations/bans on customer and/or employee non-solicits:

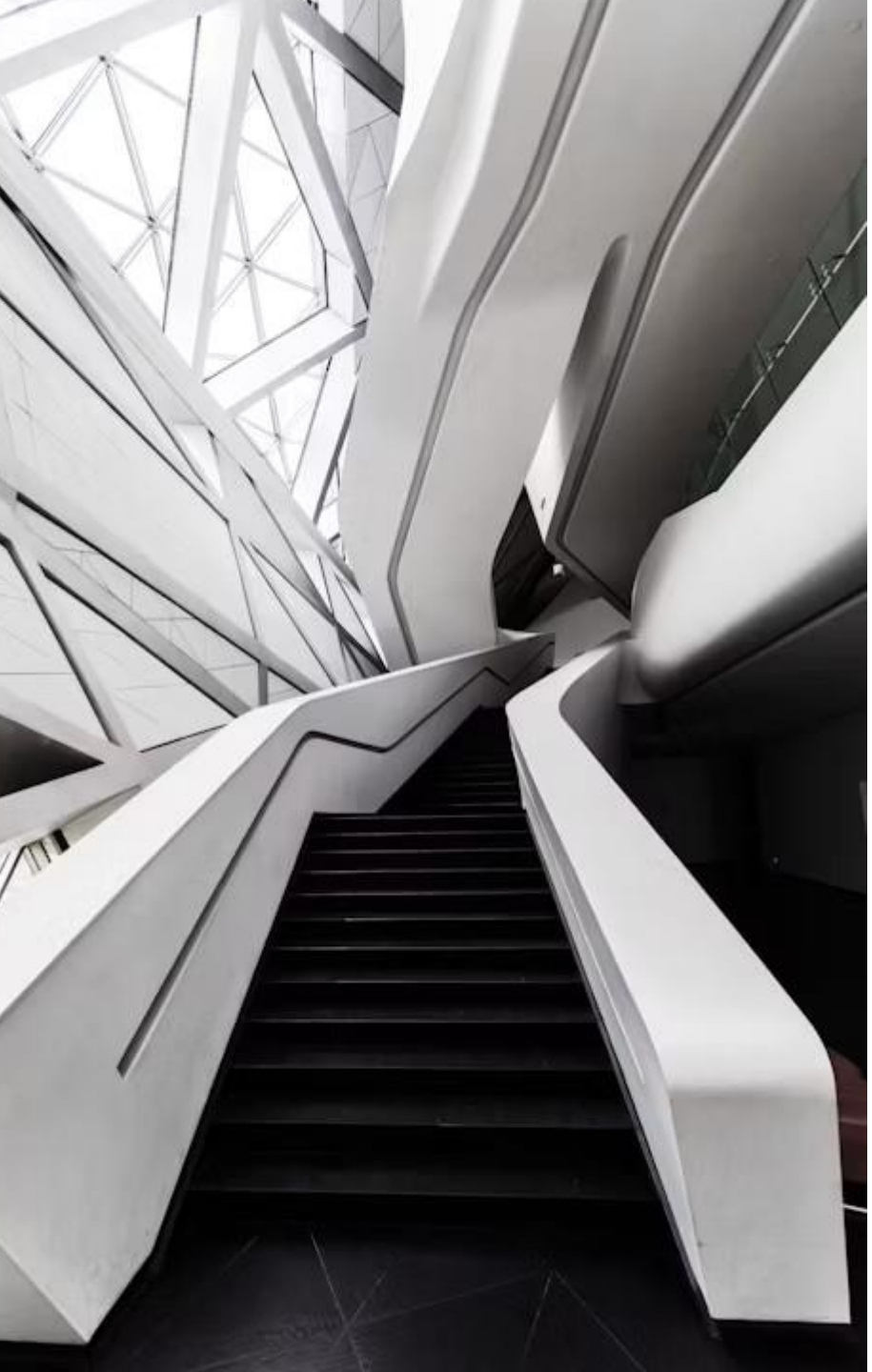
- California
- Colorado
- Illinois
- Louisiana
- Minnesota
- Nebraska
- Nevada
- North Dakota
- Oklahoma

Non-Solicits and Confidentiality Provisions At Risk Too

- Even NDAs are impacted:
  - Cases striking down/refusing to modify overbroad confidentiality provisions
    - *Brown v. TGS Management Co., LLC*, 57 Cal. App. 5th 303 (2020)
    - *Hightower Holding, LLC v. Kedir*, 2024 WL 3398361 (N.D. Ill. July 11, 2024)
  - Wisconsin requirement that all covenants (including NDAs) have a reasonable duration

FTC/NLRB Update





FTC Update

- FTC final rule that would have banned almost all non-competes was set to go into effect 9/4/24
- Nationwide injunction issued shortly before effective date
- Currently: appeals pending in 5th and 11th Circuits
- But Lina Khan, former FTC chair and champion of the Rule, stepped down
- New chair Andrew Ferguson voted against the Rule
- But not so fast…
  - FTC can still take action against particularly egregious agreements
  - Mark Meador, President Trump's nominee to fill 3rd Republican seat, suggested on Tuesday a focus on abuse of non-competes (saying they have been "overused and abused")

NLRB Update

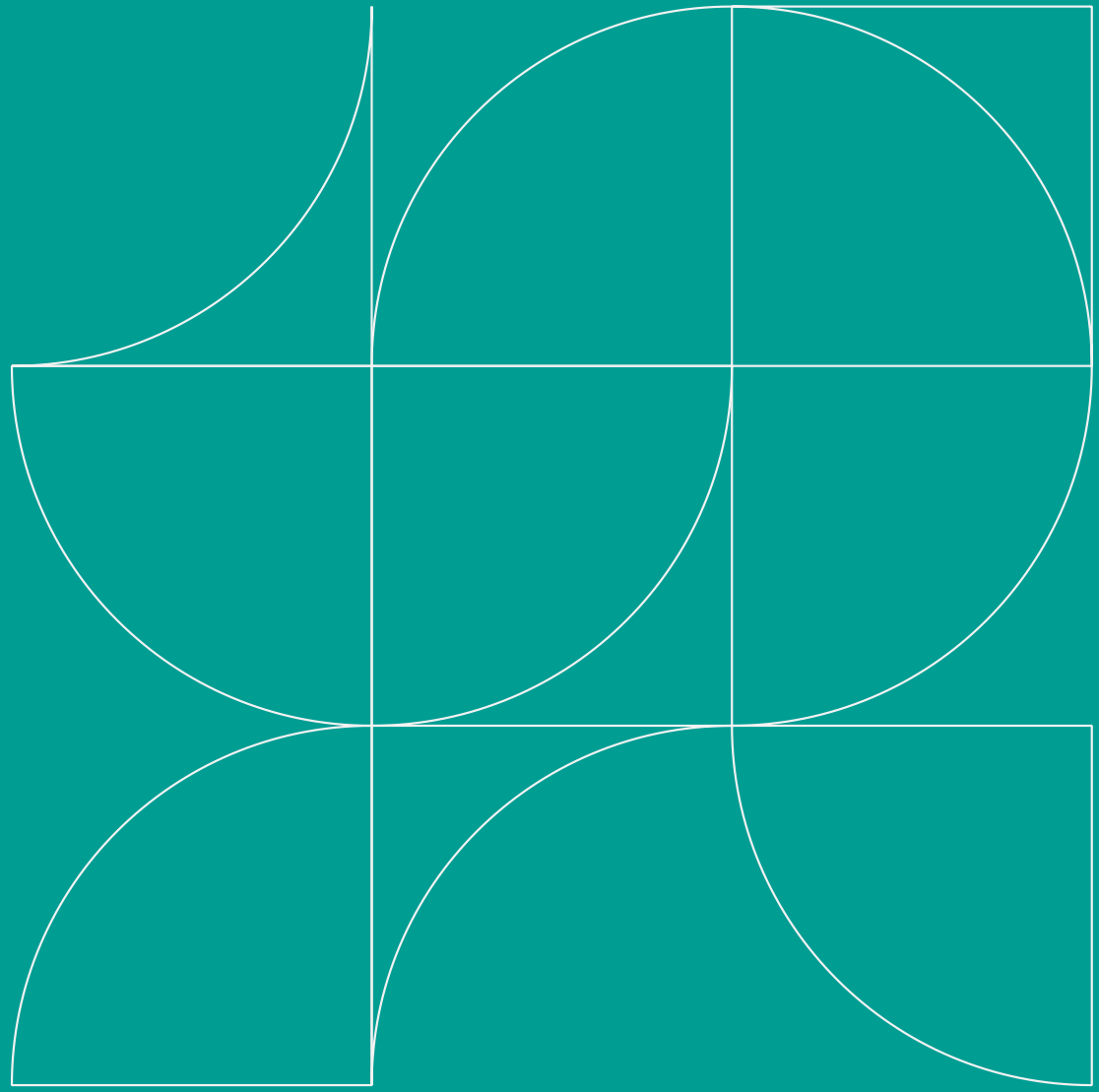
- Former NLRB GC had issued memoranda taking aim at non-competes
- May 30, 2023, memo:
  - asserted that non-competes interfere with workers' rights under Section 7 of the NLRA
- Oct. 7, 2024, memo:
  - Doubled down on May 30 memo prohibiting non-competes and directed agency to seek "make whole" relief for employees that are impacted by them.
  - Added "stay-or-pay" provisions as presumptive infringements on employees' Section 7 rights.
- Feb. 14, 2024:
  - New Acting GC Cowan rescinds these memos (and others)

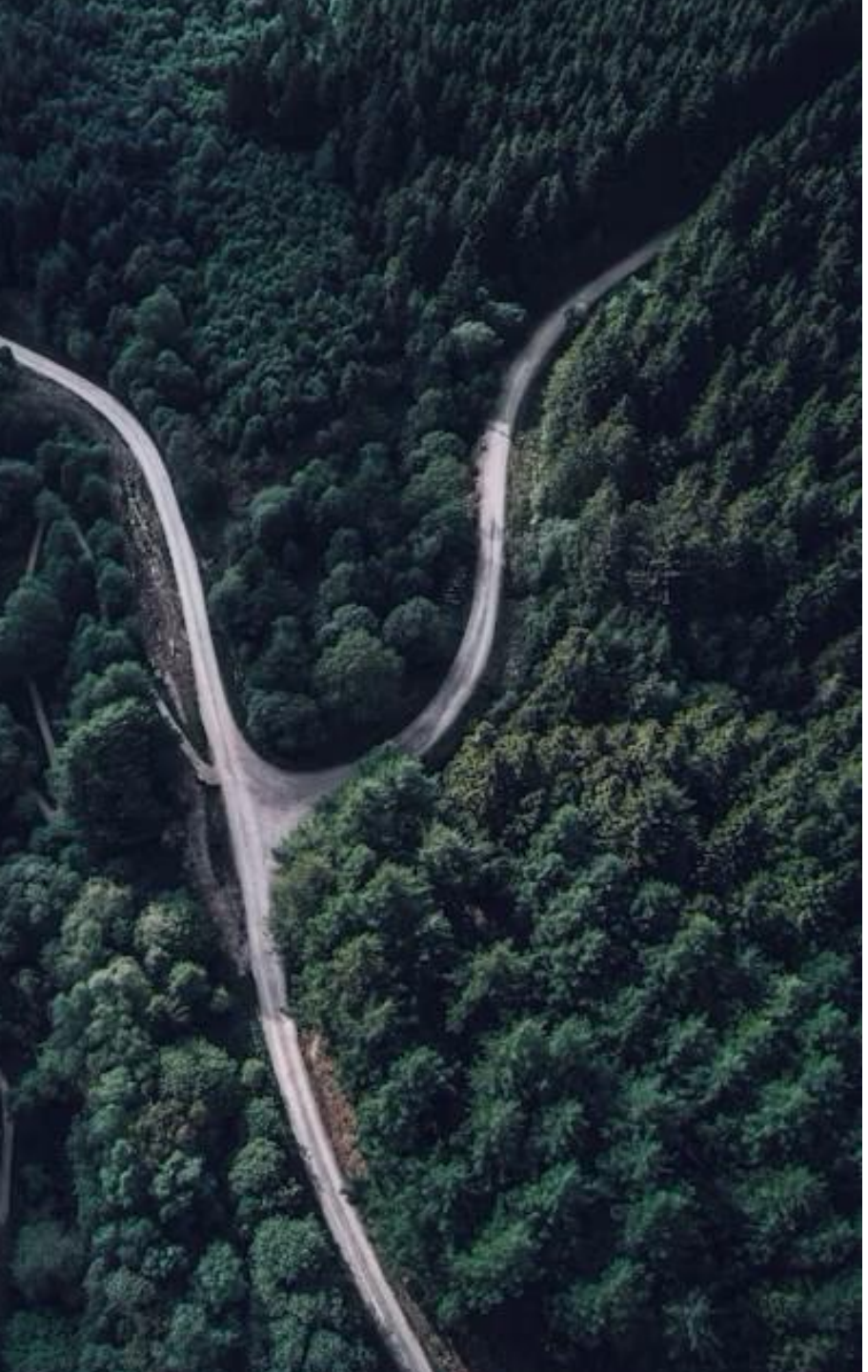
Where Does This Leave Us?

- **In sum:**
  - New legislation (especially retroactive or with penalties)
  - Agency priorities and whiplash
  - Changes in case law

Don’t rely on outdated forms!

Drafting Covenants that Work





Consider the States Impacted

- States where employees reside, AND where they predominantly perform work
- Are most employees located in one or two jurisdictions? Or spread throughout the country?
- Which is preferable:
  - Different forms of agreement for various states (or groupings of states)?
  - State-specific addenda to a main document?
  - One document with state-specific provisions in the document itself?
- Considerations:
  - Administrative burden?
  - Concern with employees seeing lesser restrictions for coworkers in other jurisdictions?

Careful Drafting Goes a Long Way

- Complying with statutory requirements may not be enough; changing opinions (public and judicial) warrant careful drafting
- Consider limiting:
  - Scope of conduct prohibited (“janitor rule”)
  - Duration
  - Geographic scope (if possible)
  - Definitions (of covered customers, “Business,” confidential information, etc.)
  - Who will get a restrictive covenants agreement (esp. a non-compete)
- Identify legitimate business interest and focus covenants on that

Other Key Terms

- Acknowledgements
  - Reasonable and necessary
  - Alternative covenants insufficient
  - Potential for irreparable harm
  - Sufficiency of consideration

But note: weight of these acknowledgements varies by jurisdiction

- Remedies
- Whistleblower protections
  - DTSA
  - SEC
  - Silenced No More acts
  - Section 7 of NLRA/other protected activity
- Assignment, severability, modification, etc.

Questions

CLE ATTENDANCE VERIFICATION FORM

Please scan the QR code to complete the digital attendance verification form to receive CLE credit for this program.

QR code directs you to our electronic form which can also be found in the calendar invite that was sent to you for this program.

You will need:

1. **Title:** Drafting Restrictive Covenants That Work – Insights from Recent Legal Battles
2. **Date Viewed:** February 27, 2025
3. **Attendance Verification Code:** SS1113

State-specific CLE credit information can be found in the form.

thank you

For more information, please contact us

Dallin R. Wilson
email: drwilson@seyfarth.com

Dawn Mertineit
email: dmertineit@seyfarth.com