Is there Reason to Consider Caution When Implementing Non-Compete Covenants?

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FEDERAL GOVERNMENT ASSERTS ITSELF REGARDING NON-COMPETE AGREEMENTS

In a publication issued by the White House at the end of October, the following conclusion was reached:

Most workers should not be covered by a non-compete agreement. Though each state faces different circumstances, we believe that employers have more targeted means to protect their interests, that non-compete agreements should be the exception rather than the rule, and that there is gross overuse of non-compete clauses today.[1]

Further elaborating on that conclusion, 'the White House,' has gone further and recommended what it calls 'best practices' which it is generically encouraging State legislatures to adopt, in order to give the recommendations the force of law:

1. Ban non-compete clauses for categories of workers, such as workers under a certain wage threshold; workers in certain occupations that promote public health and safety; workers who are unlikely to possess trade secrets; or those who may suffer undue adverse impacts from non-competes, such as workers laid off or terminated without cause.

2. Improve transparency and fairness of non-compete agreements by, for example, disallowing non-competes unless they are proposed before a job offer or significant promotion has been accepted (because an applicant who has accepted an offer and declined other positions may have less bargaining power); providing consideration over and above continued employment for workers who sign non-compete agreements; or encouraging employers to better inform workers about the law in their state and the existence of non-competes in contracts and how they work.

3. Incentivize employers to write enforceable contracts, and encourage the elimination of unenforceable provisions by, for example, promoting the use of the 'red pencil doctrine,' which renders contracts with unenforceable provisions void in their entirety.

Even in states that do not enforce non-competes for some or all workers, employees may be adversely affected by a non-compete clause in a contract. To promote compliance and enforcement, states should assign appropriate remedies or penalties for employers that do not comply with state non-compete statutes.[2]

While I would have assumed this was an area of the law beyond the traditional scope of the federal government's attention, this was only the most recent in a series of public pronouncements on the subject from Washington.

In March, the Treasury Department issued a report[2] in which it noted that, while non-compete agreements have their place in modern business, nevertheless, Treasury speculated, they may have an adverse effect on the economic interests of regular, rank-and-file workers, as well as on business generally. They drew these conclusions from the fact that 30,000,000 workers in America are said to be subject to non-compete clauses and the observations that: a worker's bargaining power is reduced after a non-compete is signed, possibly leading to lower wages; non-competes may induce workers to leave their occupations entirely, foregoing accumulated training and experience in their fields; and that reduced job churn caused by non-competes reduces labor productivity by minimizing the matching of workers and firms. Treasury also noted that, within the last five years, several states have enacted, or are considering, statutory changes to limit the scope of non-compete contracts.

So, the Treasury Department offered several recommendations:

- Increase transparency in the offering of non-competes.
- Encourage employers to use enforceable non-compete contracts.
- Require that firms provide 'consideration' to workers bound by non-compete contracts in exchange for both signing and abiding by non-competes.

That Treasury Report was followed, last May, by another report[3] by 'the White House,' in which it noted that: 'In at least part of the economy, evidence suggests that competition for consumers and workers is declining, and the number of new firms each year is experiencing a downward trend. In addition to this trend, there has been a decrease in - business dynamism' - the so-called churn of firms and who is working for whom in the labor market 'since the 1970s.' The White House charged that non-competes may be to blame: 'One factor driving these issues may be institutional changes in labor markets, such as greater restrictions on a worker's ability to move between jobs.' As a result, the White House announced that it would be convening groups of experts to study the situation and make recommendations to solve these perceived 'problems' with non-compete clauses.

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Apparently, the new recommendations from the White House are the result of that study.

Ordinarily, such generic talk out of Washington[4] might be of little consequence to lawyers engaged in business way out in Ohio. But, you may want to be attuned to arguments that are currently going on in other states.

SOME STATES SHOWING CONCERN ABOUT THE SCOPE OF NON-COMPETES

Earlier this year, the New York Attorney General gained national notoriety by asserting claims against prominent businesses that their non-competition practices were 'unfair practices' in a legal sense. To begin with, in June, the A.G. announced that 'Law 360,' a subsidiary of Lexis Nexis, had agreed to voluntarily (without suit having been filed) discontinue use of formerly mandatory one-year non-compete agreements required routinely for all positions other than top executives. The premise for the A.G.'s grievance was that, since New York law only allows non-competes in limited circumstances, such as to protect trade secrets or to cover employees with unique skills, broadly applied non-competes would likely be unenforceable in court - and, therefore, it was an unfair practice for the employer to make employees, generically, to believe that they could be bound by them.

The New York A.G. followed that up with a settlement reached with Jimmy John's sandwich chain. There, the main company issued non-compete templates for its franchisees to use, by which even an unskilled sandwich maker was barred, for 2 years, from working at another sandwich seller within 2 miles. Once again, individuals with virtually no access to secret information doing a rather menial task were prevented from going down the road to another sub shop, and, so, reduced leverage when, for example, seeking a raise or a better shift. The employer gave up on the practice without suit being filed.

Then, in August, another deal was reached with EMSI, a Texas company that provides medical information services across the country, including in New York. All the New York employees were required to sign a 9-month non-compete that prevented them from working at any competitor within 50 miles of where they had worked for EMSI. A phlebotomist was offered a job by another company, with better hours, higher pay, and no traveling; but that company withdrew the offer when it learned of her non-compete. After the A.G. became involved, EMSI agreed to release her and any other employees from their covenants and agreed to discontinue using the agreements for all but executives.

Meanwhile, in Illinois, the Attorney General filed an actual suit against the Jimmy John's chain for the same conduct as New York found troublesome. The Attorney General asserts that the broadly applied non-competes are unenforceable for low-wage, at-will employees because they serve no business interest and are simply intended to chill employees' desires to look for employment at competitors. Once again, there was not a specific statutory premise for the claim; rather, the A.G. claims authority under the statutes against unfair acts or practices. (That case remains pending at this writing.)

And, the Legislature there enacted the 'Illinois Freedom to Work Act,' which states:

(a) No employer shall enter into a covenant not to compete with any low-wage [$13/HOUR] employee of the employer.
(b) 'A covenant not to compete entered into between an employer and a low-wage employee is illegal and void.'

Other states' legislatures have recently weighed in on both sides of the issue; for example:

Hawaii	2015	HB1090 - employee non-compete and non-solicitation contracts declared void
New Mexico	2015	SB325 - makes non-competes for health care providers unenforceable
Alabama	2015	HB352 - expressly authorizes non-competes under specified circumstances
Arkansas	2015	SB998 - expressly authorizes non-competes under specified circumstances
New Hampshire	2014	SB351 - non-competes must be disclosed to a potential employee before hire to be enforceable
Oregon	2015	HB3236 - modified existing law which allows non-competes under specified circumstances by limiting them to 18 months instead of 2 years

Bills are pending to outlaw noncompetes in at least the following states: Maryland, Massachusetts, Michigan, Minnesota, New York, Pennsylvania, Rhode Island, and Washington.

OHIO NON-COMPETE PRINCIPLES REMAIN UNAFFECTED - SO FAR

So far, there seems to be little indication that anti-non-compete mania has gathered any steam in Ohio.

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Attorney General DeWine has given no indication that he is stalking Jimmy John's, or anywhere else, looking for non-compete grievances by employees. And, the sole current proposal pending in the Legislature is SB 228, which would be very focused in application, even if it were to pass:

No broadcasting industry employer shall require a broadcast employee or a prospective broadcast employee to agree, as a condition of employment with the broadcasting industry employer, that at the conclusion of the employment with the broadcasting industry employer, the employee will refrain from obtaining employment in a specified geographic area, for a specific period of time, with a particular employer, or in a particular industry.

Nor do Ohio Courts appear to be rethinking existing (fairly pro-business) groundrules for non-competes in Ohio. For example, in Saunier v. Stark Truss Co.[5], the contract before the 5th District was a one year non-compete applicable to a 100 mile radius relative to any employer whose business was substantially similar - with the decision of whether the new employer is deemed a 'competitor' to be determined at the discretion of the former employer. When the employee tried to challenge the former employer's decision that the new employer was a competitor, the Court held that, if the language of the contract is clear, it is not up to the courts to create a new contract for the parties - language that left the decision to the 'sole discretion' of the prior employer was both clear and legally enforceable.

In another decision from earlier this year, AK Steel v. ArcelorMittal USA[6], an executive left AK Steel to work for ArcelorMittal. He had agreed to a worldwide non-compete with another steel manufacturer for a one year period. The trial court granted an injunction, but only for 6 months, holding that enforcing it for the full year would be an undue hardship, which outweighed the interests AK Steel was trying to protect. But, the Court of Appeals reversed - holding that it was wrong to cut the period of restraint in half, and stating: '- too often courts have attempted to rewrite contracts for parties that appear after the fact to be more equitable to one or more of the parties.' 'Although we acknowledge that a one-year period of prohibition from employment in the steel industry amounts to some hardship, we find that it does not amount to an undue hardship, which is relevant to whether the agreement is -unreasonable.'

The Twelfth District summarized the continuing/current applicable law by noting that a non-compete must be reasonable; and, under Raimonde v. VanVlerah, 42 Ohio St. 2d 21 (1975), the test for that is:
1 The restrictions are not greater than that which is required to protect the employer.
2 It does not impose an undue hardship on the employee.
3 It is not injurious to the public.

Moreover, to make this analysis, these factors are to be considered:
1 The absence or presence of limitations as to time and place.
2 Whether the employee represents the sole contact with the customer.
3 Whether the employee is possessed of confidential information or trade secrets.
4 Whether the covenant seeks to eliminate competition which would be unfair to the employer or merely seeks to eliminate ordinary competition.
5 Whether the covenant seeks to stifle the inherent skill and experience of the employee.
6 Whether the covenant operates as a bar to the employee's sole means of support.
7 Whether the employee's talent which the employer seeks to suppress was actually developed during the period of employment
8 Whether the forbidden employment is merely incidental to the main employment.

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SO - WHAT DO WE DO?

Although there seems to be no indication that any national trend is having an identifiable affect upon how Ohio law sees non-competes, I remain aware of the fact that not all Judges view them from the same perspective. For example, in Accordia v. Fischel[7],the Supreme Court reached the conclusion that, when a company holds a non-compete, and then merges with another company, the resulting merged company may enforce the non-compete. However, in a dissent, Justice Pfeifer began his analysis as far back as 1414, noting that noncompetes are disfavored by courts generally, analogizing them to indentured servitude. In urging that they should be enforced only to the extent needed to protect employer goodwill or trade secrets (not unlike the reasoning being espoused by the White House), he concluded:

'In Dyer's Case, Y.B. 2 Henry 5, fol. 5, pl. 26, the court concluded that the non-compete agreement - is void because the condition is against the common law, and by God, if the plaintiff were present he should rot in gaeol till he paid a fine to the King.' That was justice.'

Out of a healthy respect for the possibility that a similar opinion may be held by any trial court, it may be prudent to approach non-compete clauses with the following notions in mind. First, consider counseling restraint in the inclination of some employer-clients to require sweeping, across-the-board non-competes relative to rank-and-file workers. In that vein, I encourage the client to actually think about and openly articulate what the risk/business interest is that needs to be protected; if that much can be accomplished, then it makes some sense to limit the wording of non-competes to employees, circumstances, territories, and time periods which are reasonably impacted by those risks/interest. Such an exercise not only is in keeping with principles of Ohio law, but it entirely avoids the kind of arguments made against Jimmy John's by the Attorneys General in New York and Illinois. Finally, there seems to be little dispute that non-solicitation of actual customers and securing actual trade secrets are legitimate subjects of protection by an employer; so, again, to the extent a contract focuses on those issues, the Jimmy John problems do not arise.

Endnotes

[1]https://www.White House.gov/sites/default/files/competition/noncompetes-calltoaction-final.pdf

[2]https://www.treasury.gov/resource-center/economic-policy/Documents/UST%20Non-competes%20Report.pdf

[3]https://www.White House.gov/sites/default/files/non-competes_report_final2.pdf

[4]Obviously, had Mrs. Clinton been elected to run the White House, one might have expected the anti-noncompete drumbeat to continue. It seems less likely that a Trump White House will have the same enthusiasm to squash non-competes, based on Mr. Trump's own use of them; i.e., it was widely reported that, with regard to his own staffing relative to the election campaign, his organization required anyone wanting to serve as an employee, an independent contractor, or even a volunteer, to sign off on an agreement that included these clauses, among others:
• No Disparagement. During the term of your service and at all times thereafter you hereby promise and agree not to demean or disparage publicly the Company, Mr. Trump, any Trump Company, any Family Member, or any Family Member Company or any asset any of the foregoing own, or product or service any of the foregoing offer, in each case by or in any of the Restricted Means and Contexts and to prevent your employees from doing so.
• No Competitive Services. Until the Non-Compete Cutoff Date you promise and agree not to assist or counsel, directly or indirectly, for compensation or as a volunteer, any person that is a candidate or exploring candidacy for President of the United States other than Mr. Trump and to prevent your employees from doing so.
• No Competitive Solicitation. Until the Non-Solicitation Cutoff Date you promise and agree not to hire or solicit for hiring, or assist any other person, entity or organization to hire or solicit for hiring, any person that is an independent contractor of, employee of an independent contractor of, or employee of Company or any other Trump Person and who at any time provides services for the project or objective for which you or your employer, as applicable, are being engaged.

[5]2016-Ohio-3162 (5/23/16 5th Dist.).

[6]2016-Ohio-3285 (6/6/16 12th Dist.).

[7]133 Ohio St. 3d 356 (2012).