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Non-Competes Under Attack

Trends in Restrictive Covenant Enforcement and Related Drafting Considerations

Sean M. Becker
Andrew J. Clark

Author Contact Information:
Sean M. Becker
Vinson & Elkins L.L.P.
Houston, TX

sbecker@velaw.com
713.758.2646

After an era in which many employers expanded the use of restrictive covenant agreements and extended non-competition and non-solicitation obligations deep into their organizations, there has been legislative and judicial blowback. Recent state-level initiatives have limited the circumstances in which non-competes will be enforced, and the outgoing Obama administration encouraged further checks on agreements that restricted employees' movement. Courts have responded by closely scrutinizing employers' documentation and, in many instances, exercising equitable powers not to enforce restrictions absent a strong showing of imminent irreparable harm. In light of this trend, it has become increasingly important for employers—especially those that operate in multiple jurisdictions—to consider evolving standards for non-compete enforcement when considering how to structure, and whether to enforce, their restrictive covenant agreements.

I. The "Jimmy John's Rebellion" and Resulting Barriers to Non-Compete Enforcement

In May 2016, President Obama's White House published a report[1] that criticized non-compete agreements, especially when applied to low-wage employees. The report outlined how prevalent non-competes had become. According to the report: i) nearly 20% of all U.S. employees (including 14% of employees earning less than $40,000 per year) were subject to non-competes; and ii) from 2002 to 2013, there had been a 61 percent rise in the number of employees getting sued by former companies for breach of non-compete agreements. The White House criticized the perceived economic effects of excessive restrictions, expressing concern that the agreements "constrict the labor pool," "reduce job mobility and worker bargaining power," "stifle innovation," "restrict consumer choice," and "depress wages." The report also praised burgeoning state initiatives to restrain the use and enforcement of "unnecessary" non-competes.

By the middle of last year, the Jimmy John's sandwich chain had become a prime – and perhaps most visible – example of what most people deemed restrictive covenant overreach. The company, which employs low-wage, hourly "sandwich artists" at over 2,000 locations in the United States, barred its sandwich makers from taking jobs with competitors for two years after leaving the company, as well as from working within two miles of any Jimmy John's store at a business that made more than 10 percent of its revenue from sandwiches. Presumably, this could have kept a minimum wage sandwich maker from accepting a job as a clerk at a nearby convenience store.

In June 2016, New York's Attorney General began investigations to redress "unconscionable contractual provisions."[2] The investigations resulted in settlements with several companies, including Jimmy John's, in which the companies agreed to reform their non-compete practices. In December 2016, Illinois's Attorney General announced a similar settlement in which Jimmy John's reformed its non-compete practices and paid $100,000 to the state's attorney's office

[1] Non-Compete Agreements: Analysis of the Usage, Potential Issues, and State Responses (May 2016), *available at* https://obamawhitehouse.archives.gov/sites/default/files/non-competes_report_final2.pdf.
[2] *See* N.Y. Executive Law § 63(12).

to "raise public awareness regarding the legal standards for enforceability of non-compete agreements."[3]

New York and Illinois are not the only states where officials have taken action to curtail restrictive covenants, and Jimmy John's is not the only employer facing increased scrutiny. Across the country, state officials and legislatures have implemented reform initiatives, such as limiting the permissible terms within non-competes, implementing wage thresholds before an employee can be subject to certain restrictions, enforcing heightened consideration requirements, and barring choice-of-law and forum selection provisions that might allow an employer to evade unfriendly state law requirements. Some of the trends in non-compete curtailment are summarized below.

a. Statutory Limitations on Non-Compete Length

In recent years, several states have gone beyond the traditional – and often variable – "reasonableness" standard to evaluate the permissible duration of a non-compete, and imposed statutory limits on how long an employee non-compete can last. Of note:

- In June 2015, Oregon limited the permissible term of an employee non-compete to 18 months post-employment.[4]
- In March 2016, Utah limited the permissible term of an employee non-compete to one year post-employment.[5]
- In March 2016, Idaho limited the permissible term certain restrictive covenants to 18 months post-employment unless the employer provides consideration in addition to employment or continued employment.[6]

In February 2017, Nevada lawmakers introduced a bill containing an even stingier restriction—limiting the permissible term of a restrictive covenant to three months. The bill, Nevada Assembly Bill 149, would become enforceable on July 1, 2017, if passed.

b. Wage Thresholds

Some states have considered establishing wage thresholds that would make non-compete restrictions per se unenforceable unless employees subject to those agreements were paid a specified amount. In August 2016, Illinois enacted a wage threshold that prohibited employers from entering into non-compete agreements with employees making less than $13.00 per hour.[7] In January 2017, Maryland lawmakers proposed a similar bill, with a wage threshold of $15.00 per

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[3] Illinois Attorney General Press Release (Dec. 7, 2016), *available at* http://www.illinoisattorneygeneral.gov/pressroom/2016_12/20161207.html

[4] Oregon Revised Statute § 653.295(2) (effective January 1, 2016).

[5] Post-Employment Restrictions Act, Utah Code § 34-51-101, et. seq. (effective May 10, 2016).

[6] Idaho Code Ann. §44-2704 (effective July 1, 2016).

[7] Freedom to Work Act, Public Act 099-0860 (effective January 1, 2017).

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