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What Employers Can Do in a World Without Noncompetes

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Forfeiture clauses are one tactic. They provide a meaningful disincentive for employees to engage in competitive behavior.

Noncompetes are under siege on multiple fronts.

Highlighted on the national stage by President Biden's July 9, 2021, Executive Order on Promoting Competition in the American Economy, noncompetes have been under attack from state and federal legislatures, the Federal Trade Commission and courts.

As a result, employers have a need to evaluate options to protect their confidential information and trade secrets, as well as their human capital.

The noncompete landscape

The FTC has been leading the federal government's efforts to curtail the use of noncompetes — even though this has traditionally been an area addressed by state legislatures.

The FTC's January 5, 2023, proposed rule would ban nearly all practical uses for noncompetes. The proposed rule faces a tough road to implementation, but the FTC has been busy pursuing enforcement actions, including in the typically less-scrutinized sale of a business context.

Some states have taken similar approaches to bans. This year alone, Minnesota joined the ranks of California, North Dakota and Oklahoma in banning nearly all noncompetes.

The New York state legislature looks to follow suit, having recently passed a broad ban on the use of noncompetes. But it's unclear whether the governor will sign the bill.

At the same time, courts have been active in ensuring that noncompetes are drafted narrowly.

In Delaware — a state once considered relatively “safe” for the enforcement of noncompetes — vice chancellors have struck down noncompete provisions.

Whether in the context of a sale of business (Kodiak Building Partners v. Adams (Oct. 6, 2022) and Intertek Testing Services v. Eastman (March 16, 2023)) or forfeiture-for-competition (Ainslie v. Cantor Fitzgerald (Jan. 4, 2023)), Delaware judges have not hesitated to strike noncompetes. They also have refused to blue pencil agreements with greater frequency.

How employers can respond

Given this context, employers should consider the following steps to diversify and strengthen efforts to retain employees and protect trade secrets.

Strengthen non-solicitation agreements: Employers should ensure their employee and client non-solicitation agreements are appropriately tailored both in geographic and temporal scope to protect their personnel and client relationships from being lured away by departing employees. With increasing frequency, courts look unfavorably upon such agreements that are overly broad and/or not tethered to the employer’s business needs.

Audit confidentiality agreements: Employers should consider conducting an audit of the confidentiality measures already in place to ensure they are using all available tools to secure their confidential information, including, in particular, at the time of an employee departure.

As simple examples, employers may consider restricting access to sensitive information using either password-protection or file-sharing software that restricts access to only those individuals who have a need-to-know basis.

An added benefit is that courts generally look favorably at employers that have robust confidentiality and noncompete agreements and support them with comprehensive measures to maintain the privacy of their information.

Employers also should regularly update and recirculate the company’s confidentiality policies. In the relatively new world of hybrid and remote-work options, confidential business information has the potential to be regularly accessed and stored on unsecured networks and devices.

In addition to requirements that employees acknowledge and agree to confidentiality policies, employers can implement security measures such as prohibitions against using USB or other portable drives, prohibiting downloads of work files to personal devices, requiring that employees work exclusively on company devices or remote desktop software and/or use a virtual private network (VPN) when accessing company servers.

And upon an employee departure, employers should consider whether it is appropriate to conduct an audit to confirm the departing employee has deleted all business information from his or her personal devices.

Forfeiture-for-competition: A forfeiture clause requires a departed employee to forfeit unpaid benefits and, in some instances, pay back benefits already received if they engage in competitive behavior. A forfeiture clause can be a powerful tool because it provides a meaningful disincentive for employees to engage in competitive behavior without requiring employers to file a lawsuit or seek a court order.

Heightening retention: In a world in which non-compete clauses are coming under intense scrutiny, employers are well served by focusing efforts on employee retention through “carrots,” rather than just the restrictive covenant “stick.”

Employers can incentivize employees who might consider jumping ship to a competitor to stay put through “stay bonuses” and other offers of deferred compensation, such as equity grants with defined vesting schedules.

Employers may also consider appealing to long-time employees with offers of “sabbaticals” or other ways to “reset” in order to keep employees who would consider leaving for a change of pace, or those who are in need of a fresh start.

Employers can also offer education stipends or tuition repayment programs conditioned upon length of service. For newer workers, these types of programs not only garner goodwill, but provide an immediate tangible benefit to employees who may be looking to increase their skill sets.

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