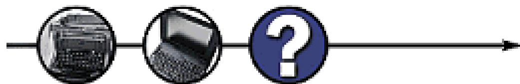
Non-Compete Agreements: The Good, the Bad and the Ugly
By Ed Winn III

As the labor market tightens and competition among rental stores increases, there is a growing trend among rental dealers to require written non-competition agreements as a condition of employment. The prevalence of these agreements can increase the friction between employer and employee, between competing rental companies and, additionally, raises a number of legal issues for all concerned. Who should sign them? What happens if an employee refuses to sign an agreement? Are they enforceable? How does an employer enforce them? How can a rental dealer determine if an applicant has signed one with another company? These are just a few of the questions that non-competition agreements raise.



Non-competition agreements are found most often in more comprehensive contracts of employment, but may occasionally be stand-alone documents. Here is how a typical non-competition clause might read:

"While the Employee is employed by the Company, Employee agrees that he will not engage in any activities that compete with the business of the Company, directly or indirectly. Employee further agrees that for a period of ___________ months after the termination of this agreement, with or without cause, he shall not be employed in a management position or own an interest greater than 5 percent in any company or other entity or own or operate a sole proprietorship which engages in the rental of household goods similar to those being rented by Employer at the present time. This covenant not to compete shall be limited to a geographic area equal to a radius of _________ miles from the location where the Employee is working or has worked [from any present location in which Employer presently owns or operates a rental store]."

In addition to this language, there are other contractual provisions that employers use to seek to control post-employment behavior, which are all loosely referred to as non-competes. Nondisclosure agreements prevent an employee from disclosing an employer's confidential information, which would include customer lists, to anyone outside the company. As a practical matter, there are state and federal statutes that protect a company's confidential information and there are criminal statutes prohibiting the theft of trade secrets, which, in most states, would include customer lists.

There are also non-solicitation agreements that prohibit former employees from contacting existing customers to try to lure them to start doing business with a new company. There are also non-raiding agreements which prevent employees from trying to hire former co-workers to come to work for the new company. An employer might ask a new employee to sign some or all of these agreements as a condition of employment.

Will the law uphold your non-compete agreement?

There can be legal consideration issues if an employer requests existing employees to sign a non-compete agreement. The employee can argue that he did not get anything in exchange for agreeing to the non-compete and contract law provides that consideration must flow both ways for a contract to be enforceable. The employer can argue that the employee is getting continued employment in exchange for signing the non-compete, although in some states, refusing to sign a non-compete may not be grounds for termination. It is safer for

employers to have employees sign non-compete agreements when they begin work, when they get a raise, promotion or some other new employment benefit which can then be exchanged for the non-compete.

Rental dealers want employees to sign non-competition agreements to keep them from running off to the competition one day with the company's secrets and know-how. For mid- and upper-management employees, such information might include marketing strategies, proposed new store locations, new product lines and other sensitive information that give the company its competitive edge.

At the store level, it is knowledge of the customer base that a dealer wants to protect. It is only through a store manager's employment in a rental store that the employee learns who the customers are, where they live, how they pay, who the bad customers have been and the habits, generally, of the customer base. In the rental business, that is valuable information. From an employer's point of view, an employee should never be able to take information learned on the job to a competing company and use it against the company where this information was obtained.

The employer's interest is in protecting the business and making it as competitive and valuable as possible. In the rental industry, a long-standing store manager could go across the street and a certain number of customers loyal to that manager would follow, assuming products and rental rates were competitive at the new store. In a rental store, there is real value in the relationships built between store employees and the customer base over time, more so, perhaps, than in most other businesses. If Best Buy loses a salesman to a Sears across the street, it is relatively less important to the value of the enterprise than if it happens in the rental industry. Most retail stores remain product oriented. The rental business has always been much more relationship oriented; the employer wants those relationships protected.

The Freedom to Associate Freely

From the employee's point of view, it would be unfair to require him to change careers every time he changes jobs, which would be the case if non-competes were absolutely enforceable. At the same time, the employee has an interest in being able to pursue freely his employment opportunities wherever and whenever they might arise. The constitution protects an individual's right to associate freely and, more vaguely, to pursue happiness, which most people would agree includes working at the most fulfilling, best paying job available. Society has an interest in fostering competition that brings the greatest good to the most people at the lowest prices. Competition is fostered when ideas and people as well as goods and services can be exchanged with as few restrictions as possible.

What's Enforceable and What's Not

The law must grapple with these competing interests when confronted with non-competes. The law in this country, which has been developed to favor competition, generally has been crafted so that non-compete agreements are only enforceable as long as they involve "reasonable" restrictions on an employee's ability to go to work for another company. What is reasonable depends, unsurprisingly, on the circumstances of the employment. There is a difference in the law, for example, between non-compete agreements entered into by the seller of a business and made a part of the sales transaction and those entered into between an employer and an employee. The former are more enforceable since sellers and buyers have a more equal bargaining position than employers and employees and, finally, employees must be able to make a living in their chosen line of work.

In some jurisdictions, employee non-competition agreements are likely not enforceable at all, regardless of consideration issues on public policy grounds. Courts and sometimes legislatures in these states have determined that the interests in personal freedom and free market goals outweigh an employer's interests in preserving the value of the enterprise by restricting what employees can do after they leave the company. In other jurisdictions, employee non-competition agreements are enforceable as long as they are "reasonable" in terms of the geographic limits and time restrictions placed on the employee. Rental dealers seeking enforceable non-competes need to be careful in considering what is reasonable to protect the business. If they reach too far, courts may declare the non-compete to be unenforceable. Other courts may be willing to restructure an unreasonable agreement to make it reasonable by rewriting the geographic scope or the time limits. State law primarily controls non-compete agreements, but results may vary within a state depending on the district where the action is brought and the views of individual judges.

A recent article in Workforce magazine declared employee non-competes unenforceable in California, Montana, North Dakota and Oklahoma and suspect in Connecticut, Minnesota and Illinois.

What's reasonable?

What is reasonable, of course, is often in the eyes of the beholder. When fashioning geographical limits for store employee non-competes, rental dealers need to examine how far the store delivers. In smaller markets, a 25-mile radius might be reasonable if the store is regularly making deliveries that far from the store. In major urban markets, such a restriction may not be enforceable if there are no deliveries beyond a 3- or 5-mile radius. A blanket 25-mile restriction for employees in a multi-unit rental chain has been enforced in some markets and held to be unreasonable in other markets.

Restrictions on time may vary from a little as six months to as much as three to five years. The longer the time, the greater the risk that a court will rule the restriction unreasonable as "too long." A court will look at such factors as age of the store, tenure of the employee with the company and in the store, how long the store has been open and how long customers have been on the books in the store. Six months may be all that an employer can enforce against an employee of a new store. Given the turnover in rental stores, both of employees and customers alike, it is hard to imagine a court enforcing a non-compete beyond 18 to 24 months.

Enforcing a Non-Compete Agreement

A rental dealer seeking to enforce a non-compete against a former employee will typically seek an injunction - a direct court order for the employee to comply with a court order or risk being held in contempt of court. An employer might also seek money damages if the breach has been going on for a while and the employer can prove some quantifiable losses. The dealer may also sue the new employer for interfering with contractual relations and conspiracy. One way to reduce litigation is for rental dealers to ask all potential new hires if they have signed or are subject to any non-compete, non-solicitation or non-raiding agreements with another rental company. Dealers can ask these questions as part of the employment application process. Such questions will at least get the issue on the table and the hiring company will have a chance to determine whether the non-compete in question is reasonable. Then, the hiring company can ask for a waiver, pay some form of consideration for a release or move the new employee outside the territorial restriction area for a period of time.

There are still a number of rental companies that do not use non-compete agreements at all. They are aware of the uncertain enforceability of such agreements and the time and expense associated with such enforcement actions. They have concluded that employees will work for companies where they are respected, valued, treated fairly and are well compensated. Some owners have determined that they do not want to deter their employees from being able to improve themselves by taking any job the employee thinks is a better one.

Whatever a given company's philosophy about non-competes, they are a fact of life in the rental marketplace today. Good employees have always been hard to find and keep. Employees should not be surprised to have the issue arise when interviewing with a new company. They should review the provisions carefully and measure whether the employer's non-compete demands are reasonable and are something that the employee can live with. If not, the time to negotiate the particulars is when being courted for a job, not when the matter has landed in court for enforcement.