

## Protecting Client Assets When Noncompetes Are Under Attack: Effective Alternatives

By Abraham Y. Skoff | November 4, 2024

The FTC noncompete rule, under which nearly all noncompetes in the United States would have been rendered unenforceable, was vacated on Aug. 20, 2024, by the U.S. District Court for the Northern District of Texas. The court stayed the rule on a nationwide basis, holding that “...setting aside agency action under the APA has ‘nationwide effect’ ... The rule shall not be enforced or otherwise take effect ...”

On July 23, in an earlier proceeding, the U.S. District Court for the Eastern District of Pennsylvania, upheld the FTC rule.

Regardless of how the FTC ultimately fares on appeal, the FTC rule is not the only challenge to noncompetition agreements. Significant legislative proposals to limit noncompetes have been introduced in more than thirty states and in Congress. Several states have adopted legislation that increased restrictions. Several states have imposed notice requirements, and conditions involving lower wage workers. Minnesota has joined California, North Dakota and Oklahoma, in essentially banning employment related noncompetes.

But in three states—New York, Maine and Rhode Island—legislatures passed noncompete bans, and the governors vetoed those bans. New York Gov. Kathy Hochul’s veto message was instructive: “This bill would broadly prohibit all noncompete agreements in New York. ... My top priority was to protect middle-class and low-wage earners, while

allowing New York’s businesses to retain highly compensated talent. ... These companies have legitimate interests that cannot be met with the Legislation’s one-size-fits-all approach.” Gov. Janet Mills of Maine issued a similar statement.

Nevertheless, the trend has been toward greater scrutiny of noncompetition agreements. Many practitioners also report greater judicial scrutiny of restrictive covenants under existing legal standards, and more tempered discretion in evaluating judicial modification of overbroad agreements.

Many clients view employment-related noncompetes as key tools in protecting trade secrets, business relationships and business efforts. Many ask, why should we introduce employees to our clients, methods and secrets, if the employee can quit and compete with us the next day? Many ask whether there are alternate means to protect company assets.

With all of the focus on the proposed bans, some very effective and more readily enforceable—restrictions have not received adequate attention. There are several alternatives that can provide substantial protection:

**Nonsolicitation of Customer Agreements.** A “nonsolicitation of customers” agreement restricts the former employee, for a period of time, from soliciting (and, in some jurisdictions, transacting business with) those customers of the prior employer with whom the

employee dealt closely, or about whom the employee has confidential information, or whose goodwill was created and maintained at the employer's expense. Such an agreement would not restrict the employee from competing with the former employer, or from working for a competitor. The FTC carved such agreements out of its Noncompete Rule, at least where they were not so "broad or onerous," that they "functioned to prevent" the employee from seeking or accepting other work, or starting a new business. In its Supplementary Materials, the FTC states (p.81), "Nonsolicitation agreements are generally not noncompete clauses ... because, while they restrict who a worker may contact ... they do not by their terms or necessarily in their effect prevent a worker from seeking or accepting other work or starting a business. However, nonsolicitation agreements can satisfy the definition of noncompete clause ... where they function to prevent a worker from seeking or accepting other work or starting a business..."

These agreements can be particularly useful for client-facing employees. Such agreements are often enforceable where noncompetes would not be. Indeed, some recent state legislation specifically carve out such agreements, or provide a more enforceable standard. See, e.g., statutes in Washington (RCW 49.62.010(4)(a)), Oregon (ORS 653.295(5)(b)) and Massachusetts (MGL Section 24L(a)). The precise customers who can be restricted will vary; in Georgia, customers with whom the employee had material contact can be restricted, Georgia Code, Section 13-8-53(b); in New York, the customers who can be restricted are those about whom the employee has confidential information, and/or whose goodwill with the employer was created and maintained at employer expense. E.g., *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 391-92 (N.Y. 1999). In New York, the legal standard for a "nonsolicitation of customers" agreement, and a noncompete, is essentially the same, but where the "legitimate employer interest" being protected is confidential customer information, or goodwill, New York law would likely permit enforcement of a nonsolicit, but not a noncompete. Compare, *Ticor Title Insurance v. Cohen*, 173 F.3d 63

(2d Cir. 1999). In most states, a nonsolicitation agreement could not be applied to all of the employer's customers, only to those who met the specific criteria.

**Nondisclosure/Confidentiality Agreements.** Nondisclosure or confidentiality agreements, often referred to as NDAs, can be critical in protecting company assets. NDAs help define the information subject to protection and put employees on notice of the need to maintain secrecy. To enforce trade secret protection, the company will need to show that it took reasonable measures to preserve confidentiality, and the absence of an NDA can be fatal to such a showing. In California, where employment noncompetes are essentially banned, parties rely extensively on NDAs.

The FTC carved NDAs out of the noncompete rule, provided the NDA was not overly restrictive: "... an NDA would not be a noncompete ... where the NDA's prohibitions on disclosure do not apply to information that arises from the worker's general training, knowledge, skill or experience, gained on the job or otherwise; or is readily ascertainable to other employers or the general public. However, NDAs may be noncompetes ... where they span such a large scope of information that they function to prevent workers from seeking or accepting other work or starting a business ..."

While state laws vary, NDAs are generally more likely to be enforced than noncompetes, as they are viewed as being less restrictive. E.g., *OrthoFix v. Hunter*, 630 F. App'x 566 (6th Cir. 2015) (Texas law), "nondisclosure covenants are more readily enforced than non-competition covenants because they are not restraints on trade, do not prevent the employee from making use of the general experience he acquired during his employment, and do not offend public policy." ... a nondisclosure provision may be enforceable when a covenant not to compete is not."

Nevertheless, a NDA may not be enforced where it is overly restrictive. See *TLS Management & Marketing v. Rodríguez-Toledo*, 966 F.3d 46 (1st Cir. 2020);

*Brown v. TGS Management*, 57 Cal. App. 5th 303 (Cal. Ct. App. 2020).

**Key Takeaway:** The use of a focused, well drafted NDA, in tandem with an appropriate nonsolicitation of customers agreement, can be effective in protecting company assets. Even with senior executives, and employees who are not customer facing, appropriately scoped agreements can provide protection for the confidential information, trade secrets, goodwill and other interests, the law recognizes.

There are additional remedies that may be utilized in an employment context:

**Garden Leave and Severance Agreements.** “Garden leave” is a status where an employee remains an employee, and receives compensation until some date, but is separated from relevant customers, information and personnel. This is not regarded by the FTC as a noncompete. Severance agreements are regarded by the FTC as noncompetes subject to the rule. Garden leave and severance agreements will be governed by state law (unless the FTC noncompete rule is reinstated). Where the employee is well paid, courts tend to be more receptive to enforcing these restrictions, although specific enforceability needs to be evaluated under applicable state law.

**Forfeiture for Competition and Employee Choice.** Forfeiture for competition clauses provide financial penalties where the former employee chooses to compete, despite an agreement and financial incentives not to. These agreements are governed by state law, and enforcement can provide

very powerful protection. See *Cantor Fitzgerald v. Ainslie*, 2024 WL 315193 (Del. 2024). New York law recognizes a similar doctrine, the employee choice doctrine, in which restrictions may be upheld, essentially without court reasonableness review, where it was the employee’s choice to leave employment, in return for compensation.

**Litigation.** Under state and federal law, employers can protect trade secrets or confidential information through litigation. Over the last several years, trade secrets cases have resulted in some of the largest verdicts in the United States.

**Duty of Loyalty.** All employees have a duty of loyalty to their employers. That duty is defined by state law, but in every state, an employee may not misappropriate trade secrets or divert business while employed.

The other main context in which noncompetition agreements are key, is the “sale of business” context. Generally, “sale of business noncompetes” are more readily enforceable. Even in California, where employment noncompetes are unavailable, there is a statutory exception for the sale of business context.



[Abraham Y. Skoff](#) is a litigation partner at Moses & Singer, and Chair of the firm’s Trade Secrets, Noncompetes and Unfair Competition Litigation Group. He serves as Co-Chair of the Trade Secret Committee of the New York City Bar Association.