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Court cases show need for scrutiny of noncompetes

A company's intellectual property walks out the door every time an employee leaves. Because of this, noncompetition, nonsolicitation and nondisclosure agreements have become an important tool for companies seeking to protect their interests.

Many employers require that their employees sign, at hire, a standard agreement containing restrictions on post-employment conduct.

INSIDER VIEW

Mike Rosen

Three recent decisions issued by Massachusetts judges call that assumption into question. These cases, all issued in 2004, hold that a noncompete signed at an employee's hire may later become unenforceable due to changed circum-stances in the employee's job. The decisions highlight the need for employers to engage in planning to maximize their ability to protect their interests through restrictive agreements.

In Cypress Group Inc. v. Stride & Associates Inc., issued last February, staffing-company employees signed noncompetition agreements prohibiting their solicitation of customers and candidates for one year after their employment ended.

One such employee signed a noncompete when he became a manager in the company's Boston office. He later moved on several occasions into different management positions in different offices of the company. None of these changes in job position were accompanied by a new noncompete.

The court ruled that the noncompete was not enforceable due to changes in the employee's job circumstances after he signed it. Each time an employee's job changes materially such that the employee has entered into a new employee relationship, the court held, a new noncompete must be signed.

Similarly, in R. E. Moulton Inc. v. Lee, issued last June, another Massachusetts judge refused to enforce a noncompete signed by an employee in the insurance industry based on the fact that the employee's job had changed after he had signed the agreement.

The employee had been employed as a director of underwriting, a management-level position, when he signed the noncompete. He later was moved to a nonmanagerial regional sales position. The court found that the employer had not amended the agreement when the employee changed positions and did not otherwise notify the employee that he was still subject to the noncompete provision. The court therefore refused the former employer's request for an order enforcing the noncompete.

Most recently, in Lycos v. Jackson, the employee was required to sign Lycos' noncompete when she was hired into a product-management position. Her employment relationship with Lycos thereafter varied over time with respect to her salary, bonus eligibility, responsibilities, direct reports and title. The court found, therefore, that the employee's employment relationship had changed materially after she signed the noncompete and concluded that the noncompete was invalid.

In light of these recent decisions, Massachusetts companies interested in maintaining enforceable restrictive agreements need to engage in careful planning and drafting to maximize their ability to protect their interests. Several specific approaches should be considered, including:

- Incorporating into the standard offer letter and the noncompetition agreement language indicating that the agreement will continue to apply to the employee even in the event that the employee's position, title, responsibilities and/or compensation change over the course of her employment.
- Establishing procedures to maximize the enforceability of noncompetition and nonsolicitation provisions.

This should include the reaffirmation of existing contractual obligations as part of any significant change in the employee's responsibilities, particularly where the substantive focus of the position is significantly changing, or where the breadth of responsibility increases or decreases materially (for example, changes between management and nonmanagement or significant changes in sales territory).

- Adopting a broader, consistent approach to the protection of intellectual property, including electronic security, labeling of confidential materials, and exit interviews with all departing employees reminding them of existing contractual obligations and the importance of nondisclosure.

Noncompetition and nonsolicitation agreements remain useful for protecting legitimate interests and, under the right circumstances, will be enforced. But, in light of the evolving legal landscape, employers must be proactive in taking steps to protect those interests.

MIKE ROSEN is a partner at Boston-based law firm Foley Hoag LLP.