NON-SOLICITATION AND NON-COMPETE LAW IN NEBRASKA: WALKING THE TIGHTROPE OF AGGRESSIVE RESTRICTIONS AND ENFORCEABLE PROTECTIONS

HENRY WIEDRICH

CLINE WILLIAMS

WHAT ARE RESTRICTIVE COVENANTS?

Restrictive covenants are controls placed on an employee or business seller during and/or after an employment relationship or sale. They include contractual provisions such as:

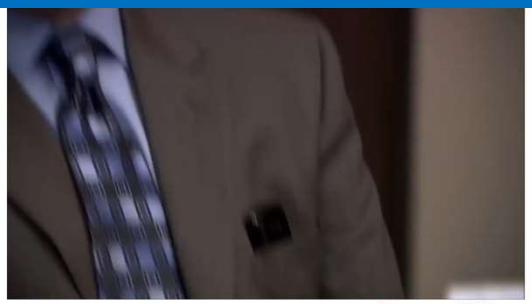
- Confidentiality and non-disclosure;
- Non-solicitation of customers/clients;
- Non-solicitation of employees/contractors; and
- Non-competition.

CLINE WILLIAMS

EMPLOYMENT CONTEXT

CLINE WILLIAMS

EMPLOYMENT CONTEXT



CLINE WILLIAMS

SALE OF BUSINESS CONTEXT

CLINE WILLIAMS

WHAT STATUTES APPLY TO THESE RESTRICTIONS?

- Nebraska does not have a statute that governs confidentiality, non-competition, or non-solicitation provisions. Court decisions control what is permissible.
- The Nebraska Trade Secrets Act (Neb. Rev. Stat. 87-501 et seq.) (which protects only trade secrets) is also often implicated in claims of violations of confidentiality agreements, but confidentiality agreements generally cover more than just trade secrets.
- In 2016, Congress passed the Defend Trade Secrets Act of 2016, which provides for a federal cause of action for misappropriation of trade secrets. (to recover attorneys fees under this statute, there is language that must be added to your confidentiality agreements or policies)

CLINE WILLIAMS

QUESTION #1

I would like to have my employee sign a non-compete agreement that prevents him from working for or starting a competitive business within 25 miles of our office. Can we do that?

CLINE WILLIAMS

ANSWER

No. In most circumstances, this type of non-compete agreement against an employee with no ownership interest in the company would not be enforceable under Nebraska law.

CLINE WILLIAMS

ANSWER (CONT.)

The cases in Nebraska analyzing restrictive covenants can be divided into two very clear groups:

(1) cases involving employees; and

(2) cases involving the sale of business, where an individual is selling a business or has an ownership interest in the business.

CLINE WILLIAMS

ANSWER (CONT.)

- In the sale of **business context**, a reasonable geographic restriction against competition, which is generally limited to the area where the company's customers are obtained and served, is enforceable if reasonable in time (generally 3 years or less, although longer restrictions have been enforced).

CLINE WILLIAMS

ANSWER (CONT.)

Sale of Business Case Law:

- *ADT Sec. Servs., Inc. v. A/C Sec. Sys., Inc.*, 15 Neb.App. 666, 736 N.W.2d 737 (2007) (3 year restriction found to be reasonable, but the covenant failed because there was no geographic scope at all)
- *H&R Block Tax Servs., Inc. v. Circle A Enter., Inc.*, 269 Neb. 411, 693 N.W.2d 548 (2005) (1 year duration was reasonable; geographic scope of 45 miles from where company was located and operated was enforceable because that was the reach of customer relationships)

CLINE WILLIAMS

ANSWER (CONT.)

Example Sale of Business Case Law (not exhaustive):

- *Presto-X-Company v. Beller*, 253 Neb. 55, 568 N.W.2d 235 (1997) (10 year restriction was unreasonable; geographic scope was unenforceable where it extended beyond the company's trade area; "While there may be a plausible basis for restricting competition within the trade area actually served by Beller Pest Control, the record reflects no reason why Presto-X needed to restrain competition 100 miles away from each location within the trade area in order to protect the value of its assets which it purchased.")

CLINE WILLIAMS

ANSWER (CONT.)

Example Sale of Business Case Law (not exhaustive):

- *Chambers-Dobson, Inc. v. Squier*, 238 Neb. 748, 472 N.W.2d 391 (1991) (2 year time limit was reasonable; customer restriction in lieu of geographic restriction was reasonably limited)
- *D.W. Trowbridge Ford, Inc., v. Galyen*, 200 Neb. 103, 262 N.W.2d 442 (1978) (15 year restriction found to be enforceable; the geographic scope of the entirety of Holt County, Nebraska was enforceable because Holt County was where the plaintiff operated)

CLINE WILLIAMS

ANSWER (CONT.)

Example Sale of Business Case Law (not exhaustive):

- *Swingle & Co. v. Reynolds*, 140 Neb. 693, 1 N.W.2d 301 (1941) (5 year restriction found to be enforceable; the geographic scope of "that part of the state of Nebraska which is south of the Platte River" was enforceable because the plaintiff-company was contemplating building a plant in that area)

CLINE WILLIAMS

ANSWER (CONT.)

- In the **employment context**, blanket non-competition restrictions are usually unenforceable, even if limited in geographic scope and time
- Although there could conceivably be a scenario where a geographic restriction is the only way to protect a legitimate business interest of the employer (*i.e.*, confidential information, customer goodwill, etc.), we have not seen a Nebraska case expressly supporting this position.
- In *Brockley v. Lozier Corp.*, 241 Neb. 449, 460–62, 488 N.W.2d 556, 564 (1992), the Nebraska Supreme Court suggested the possibility a non-competition provision might be needed to protect confidential information, but ultimately found the restriction was too long and that the information did not need protection for the 4 year period in the agreement.
- I would only fall back on this position when a non-solicitation agreement truly provides no real protection.

CLINE WILLIAMS

ANSWER (CONT.)

Is it employment or sale of business arrangement?

- Nebraska case law demonstrates that even where a selling party accepts employment with the buyer upon selling a business to the buyer, the restrictive covenants must be analyzed under the sale of business context, and not the plain employment context.
- *See Presto-X-Company*, 253 Neb. at 57-58, 568 N.W.2d at 237-38 (seller accepted employment with buyer after transaction; the court applied sale of business analysis); *ADT Sec. Servs., Inc.*, 15 Neb.App. at 673, 736 N.W.2d at 750 (selling parties executed employment agreements with buyer contemporaneous to the purchase, which agreements contained the restrictive covenants at issue; the court applied sale of business analysis).

CLINE WILLIAMS

QUESTION #2

If we can't do a geographic restriction, what is generally enforceable against a rank-and-file employee?

CLINE WILLIAMS

ANSWER

Generally, employee restrictions can include:

- Confidentiality and non-disclosure provisions (limited to certain defined, non-public information);
- Reasonable customer non-solicitation provisions; and
- Reasonable employee non-solicitation provisions.

Here we will address the customer solicitation provision.

CLINE WILLIAMS

ANSWER (CONT.)

- When a client asks this question, they are usually asking about a customer non-solicitation.
- The often-expressed thought is: "Well, if we can't stop them from working for a competitor in the area, can we stop them from contacting and soliciting our customers? Perhaps our prospective customers?"
- How broad can a customer-specific position be?

CLINE WILLIAMS

ANSWER (CONT.)

- Based on Nebraska case law, a customer non-solicitation provision must be limited to those **current** customers **with whom the employee actually had personal contact and did business while employed**.
- The provision should **not** be drafted to simply apply to all customers, regardless of whether the employee had contact, nor should it be drafted to apply to prospective or past customers (although see *Aon* case).

CLINE WILLIAMS

ANSWER (CONT.)

Best Practice Tip:

Limit the covered-customers to a certain timeframe of employment, such as: "all customers with whom Employee had personal contact and did business with *during* the last 18 (or 12) months of his/her employment with Company."

The reason for doing this is because otherwise the restriction would apply to every customer relationship handled by the employee, regardless of whether those relationships have gone stale. This could be used to call into question the enforceability of the provision.

CLINE WILLIAMS

QUESTION #3

How long should the customer non-solicitation period run?

CLINE WILLIAMS

ANSWER (CONT.)

Although it depends upon the circumstances, the general rules of thumb are these:

- 12 months is usually enforceable. This is generally the time period I recommend.
- 18 months is likely enforceable, depending upon the circumstances, but it is more aggressive.
- 24 months is aggressive, although such periods have been found enforceable.
- > 24 months is most likely unenforceable.

CLINE WILLIAMS

ANSWER (CONT.)

Example Employment Case Law (Not Exhaustive)

- *Aon Consulting, Inc. v. Midlands Fin. Benefits, Inc.*, 275 Neb. 642, 748 N.W.2d 626 (2008) (2-year non-solicitation provision limited to customers and active prospects employee had personal business dealings with during the last 2 years of employment was enforceable) (no discussion on prospects)
- *Prof'l Bus. Servs. Co. v. Rosno*, 268 Neb. 99, 680 N.W.2d 176 (2004) (customer non-solicitation that applied to all customers was unenforceable, where employee did not have personal contact and did business with all customers)

CLINE WILLIAMS

ANSWER (CONT.)

Example Employment Case Law (Not Exhaustive)

- *Mertz v. Pharmacists Mut. Ins. Co.*, 261 Neb. 704, 625 N.W.2d 197 (2001) (3-year customer non-solicitation provision was unenforceable because it was not limited to customers the employee personally did business with and it was not limited to the employer's current client base)
- *Moore v. Eggers Consulting Co., Inc.*, 252 Neb. 396, 562 N.W.2d 534 (1997) (1-year restriction that prevented employment in the employee's field and solicitation of all customers the employee had knowledge of was unenforceable)

CLINE WILLIAMS

ANSWER (CONT.)

Example Employment Case Law (Not Exhaustive)

- *Terry D. Whitten, D.D.S., P.C., v. Malcolm*, 249 Neb. 48, 541 N.W.2d 45 (1995) (a 1-year, 25 mile geographic restriction against competition was unenforceable)
- *Vlasin v. Len Johnson & Co., Inc.*, 235 Neb. 450, 455 N.W.2d 772 (1990) (a 3-year, 50 mile geographic restriction against competition was unenforceable)

CLINE WILLIAMS

ANSWER (CONT.)

Example Employment Case Law (Not Exhaustive)

- *Polly v. Ray D. Hilderman & Co.*, 225 Neb. 662, 407 N.W.2d 751 (1987) (a 3-year, 35 mile geographic restriction against competition was unenforceable)
- *Am. Sec. Servs. v. Vodra*, 222 Neb. 480, 385 N.W.2d 73 (1986) (enforcing a 3-year restriction that prevented the employee from soliciting any customer or former customer where the employee physically worked, acted in a supervisory capacity with respect to the premises, or acted as salesperson)

CLINE WILLIAMS

QUESTION #4

Can't we just be aggressive and let the Court apply the agreement as far as it deems it enforceable?

CLINE WILLIAMS

ANSWER

- **Risk**: Taking an aggressive position on employee restrictive covenants is always an option, but the employer must also be prepared to bear the risk of such position.
- The risk is that the entire restrictive covenant may be deemed unenforceable by a Nebraska court.

CLINE WILLIAMS

ANSWER (CONT.)

In some states, when this happens, the court may reform or "blue pencil" the provision to render it enforceable.

Essentially a court evaluating a restrictive covenant with "terms X, Y, and Z" might say "terms Y and Z, as drafted, are unenforceable, but term X is enforceable so we will enforce only term X."

CLINE WILLIAMS

ANSWER (CONT.)

However, Nebraska courts will not reform or "blue pencil" a restrictive covenant provision. Instead, no portion of the provision will be enforced.

CLINE WILLIAMS

ANSWER (CONT.)

Thus, taking an aggressive approach may ultimately leave the employer with no protection at all. This can be devastating when an employer has multiple employees with the same agreement, and the agreement fails. Word will spread quickly that there are no enforceable restrictions.

My counsel: A narrower, enforceable restrictive covenant is more valuable than an aggressive, potentially unenforceable covenant.

CLINE WILLIAMS

ANSWER (CONT.)

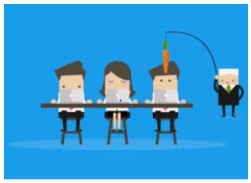
Playing the Devil's Advocate: Why might an employer take a more aggressive position?

1. They accept the risk of unenforceability and hope to capitalize on employee's misunderstanding of what is and is not enforceable.
2. Other employers may take an aggressive position simply because an enforceable restriction does not provide them with what they deem is real or worthwhile protection.

CLINE WILLIAMS

QUESTION #5

What about employee non-solicitation or employee-raiding provisions?



CLINE WILLIAMS

ANSWER

An employee non-solicitation or employee-raiding clause prevents an employee from attempting to hire away the employer's other employees or contractors.

There is little to no case law in Nebraska regarding the enforceability of such provisions.

CLINE WILLIAMS

ANSWER (CONT.)

In light of the absence of case law, we suggest that employers apply the same principles learned from the customer non-solicitation provisions.

The conservative approach is to limit these provisions to current employees with whom the employee had personal contact and set a reasonable time limit on the provision (12 to 18 months).

CLINE WILLIAMS

QUESTION #6

The employee has been working with us for about 2 years, but we would like to revise our restrictive covenant and have the employee sign it. Any issues?

CLINE WILLIAMS

ANSWER

Every contract must be supported by consideration in order for it to be binding. Consideration is generally some form of compensation or benefit, or it might be some promise to act or not to act.

Nebraska case law is clear that commencement of employment, even if it is at-will employment, is sufficient consideration to support the execution of a restrictive covenant.

CLINE WILLIAMS

ANSWER (CONT.)

No Nebraska court has held that continued at-will employment is also sufficient consideration to support the execution of a revised agreement (although I think there are strong arguments in support of that position). This poses some risk when executing a new agreement.

Employers either accept this risk and rest on continued employment, or they negate the risk by providing some additional consideration for the execution of the agreement.

CLINE WILLIAMS

ANSWER (CONT.)

This additional consideration usually comes in the form of a signing bonus, other bonus, new terms of employment (i.e., a raise, new position, termination protection, new commission plan, etc.), or some other tangible benefit to the employee for signing.

Providing additional consideration is the more conservative, risk-adverse approach.

CLINE WILLIAMS

CONFIDENTIALITY

CLINE WILLIAMS

QUESTION #7

Can't we just cover confidentiality in the employee handbook?

CLINE WILLIAMS

ANSWER

Employers can certainly include a confidentiality **policy** in its employee handbook; however, the policy will not be contractual and the employer will not be able to use it to seek damages or protect confidential information via a contractual claim.

DO NOT INCLUDE A CONFIDENTIALITY AGREEMENT IN AN EMPLOYEE HANDBOOK!!!

CLINE WILLIAMS

ANSWER (CONT.)

Employers go to great lengths to avoid having their employee handbooks treated as contracts. These efforts are all but undone when the employer then includes an express contract in the handbook.

YOUR HANDBOOK IS NOT A CONTRACT, SO DON'T INCLUDE CONTRACTUAL PROVISIONS IN IT!!!

If you want an enforceable confidentiality agreement, make it separate from the employee handbook.

CLINE WILLIAMS

ADDITIONAL DISCUSSION POINTS (HARD ISSUES)

- Will any amount/class of ownership trigger the sale of business analysis?
- If you are a multi-state employer, can you include a governing law provision and mandatory forum selection clause that elects a forum outside of Nebraska and evade this analysis? *See Cabela's LLC v. Wellman*, 2018 WL 5309954 (Del. Chancery Oct. 26, 2018).

CLINE WILLIAMS

QUESTIONS?

HENRY WIEDRICH

hwiedrich@clinewilliams.com