

Non-Compete Agreements: Enforceability and Role in M&A Deals

**Meryl Macklin and Mark Deiermann
July 23, 2019**



Presenters



Meryl Macklin, Partner, San Francisco
T: +1 415 268 1981, Meryl.Macklin@bclplaw.com

Meryl Macklin is a trial lawyer with over 30 years of experience trying and resolving complex business disputes. Ms. Macklin has served as lead trial counsel for clients ranging from major corporations to small startups in dozens of high-exposure cases in state and federal courts around the country, and regularly practices in both Northern and Southern California. Her trial experience has enabled her to develop targeted litigation strategies even when handling cases likely to settle, avoiding unnecessary and costly motion and discovery practice where possible. Her practice focuses not only on defending companies in litigation but also on counseling clients on ways to quickly resolve disputes. She is a strong team leader, with proven success partnering with clients and other professionals to accomplish results.



Mark S. Deiermann, Partner, St. Louis
T: +1 314 259 2449, msdeiermann@bclplaw.com

Mark Deiermann is a litigator whose practice primarily involves commercial and business disputes. He has extensive experience in unfair competition matters, particularly in connection with covenant not to compete, trade secret and employee unfair competition disputes. As co-leader of Bryan Cave Leighton Paisner's Non-Compete, Trade Secret and Employee Unfair Competition Team, Mark has been involved in more than 60 cases involving non-compete/trade secrets disputes; many more non-compete/trade secrets disputes which were resolved without the need for litigation; counseling many "old" employers, former employees and/or "new" employers regarding the enforceability of noncompetition provisions; drafting noncompetition agreements, reviewing the enforceability of noncompetition provisions contained in sale of business agreements; and providing advice and guidance to other attorneys within the firm in connection with non-compete disputes they are handling, including matters being handled in the firm's other offices.

Disclaimer

The information presented today is for educational purposes only. Your participation in this webinar does not create an attorney-client relationship between you and Bryan Cave Leighton Paisner LLP or any of its attorneys. Do not use the information presented as a substitute for specific legal advice from a licensed attorney.

Big Picture

1. Pre-Closing Considerations
2. Post-Closing Considerations



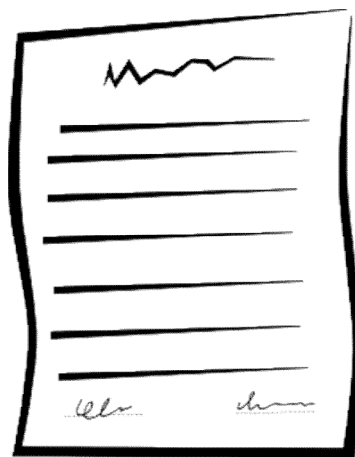
Pre-Closing

- Who has non-competes?
- Who doesn't?



Who should have non-competes . . .

- From the old employer's perspective?
- From the new employer's perspective?



Who should have non-competes (continued)

- Employees with access to trade secret information
 - Executives, Project Managers, Key Engineers, etc.
- Employees with key customer relationships and goodwill
 - Executives, Key Salespeople, etc.

Is the selling entity subject to a noncompete?

- If so, is the buyer buying its way into a noncompete problem?

As to employees with noncompetes...

- Are the noncompetes enforceable?
- If so, to what extent?
- If you're wrong, what are the potential consequences?

To determine enforceability, need to consider...

- Is there consideration?
 - Is the consideration adequate?
 - Is the consideration illusory?
 - Does the consideration comply with applicable law?

To determine enforceability, need to consider...

- Where does the employee live? Work?
- What law applies?
 - Under the contract?
 - In reality?
- Is there a forum selection clause?
 - If so, is it enforceable?

Is there an enforceable forum selection clause?

- Federal courts - enforce forum selection clauses “in all but the most exceptional cases.”¹
- State law – may be much different (e.g., CA and MA)
 - See Cal. Lab. Code § 925; Mass. Gen. Laws Ann. ch. 149, § 24L

Is the noncompete reasonable and necessary to protect the legitimate business interests of the employer?

- Customer contacts
- Trade secret information (much more than the formula for Coca-Cola)
 - All confidential, competitively valuable information that company takes reasonable precautions to protect

If the noncompete is overbroad, what will happen?

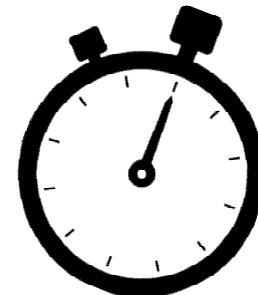
- Missouri, Kansas, and Illinois: Judicial modification permitted
- Arizona, Indiana and North Carolina: Pure “blue pencil” states
- Virginia and Nebraska: If overbroad, unenforceable
- Texas: If overbroad, no damages until noncompete is modified and employee later breaches

Is the noncompete assignable?

- What type of sale occurred?
 - Stock sale? Asset sale? Statutory merger?
- Does the contract allow for assignability?
 - If not, how do the state's courts treat silence in the contract?

When does the noncompete clock start ticking?

- Typically upon the employee's last day of employment with "the Company"
- How is "Company" defined?
- Does the acquisition constitute a termination with the old employer and start the clock ticking?



Even if key employees already have noncompetes, should they sign a new one?

- It depends on, e.g.:
 - Adequacy and enforceability of existing agreement
 - Extent to which the existing agreement can be modified, expanded, clarified, etc.
 - Assignability of the existing agreement

What if key employees are not locked into “good” noncompetes?

- They could leave, take business with them, work for a competitor, etc.
- You could have a very unhappy client who just lost value in the acquisition deal

What if the buyer wants seller's counsel to opine that the “deal covenants” are enforceable?

- Don't do it.
- Enforcement of noncompetes is very fact-specific, with numerous variables, legal arguments, etc.
- A couple of sale-of-business examples...

The deal is done, and a noncompete dispute develops. Now what?

**Much of the legal analysis remains the same.
But now you need to consider the costs and
realities of litigation.**

Noncompete litigation is usually:

- Fast-paced
- Front loaded for fees/expenses
 - Possible sticker shock
 - Need to manage expectations

Red-lined drafts of the noncompete and related emails may be very important

- What did the parties discuss, negotiate, etc.?
- Why did the buyer say it needed the noncompetes agreed upon?
 - Did the seller indicate it understood and/or agreed with the buyer's positions?

Additional Considerations

- Will the buyer be entitled to all of the seller's documents, including pertaining to the deal?
- If so, and you're representing the seller...

If (i) you represent the buyer, (ii) the deal-related noncompetes are not enforceable, and (iii) as a result, the buyer is surprised or unhappy...

- You may have to provide your files to the buyer
- Consider documenting any cautions you provided to the buyer regarding the noncompetes

Questions?
Comments?

BRYAN
CAVE
LEIGHTON PAISNER **BCLP**

bcplaw.com