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Spark's wake: Let's review noncompetes, but carefully

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Last week, Spark Capital, a local venture capital firm, wrote a letter to Gov. Deval Patrick asking that legislation be introduced to prohibit the enforcement of noncompete clauses as part of employment contracts. The Spark idea, while intriguing, raises interesting questions about the role of "noncompetes."

The idea of outlawing "noncompetes" is an outgrowth of the differences in the way that courts in California and Massachusetts have historically treated such provisions. Moreover, recent academic studies indicate that employee mobility may play a role in the higher rate of growth that Silicon Valley has enjoyed in the last two decades compared with Route 128.

The shorthand legal analysis is that noncompetes are "unenforceable restraints upon trade" in California, but are permitted in Massachusetts. The reality is a little more nuanced, as Massachusetts courts have placed definite limits on the scope of the provisions.

Massachusetts courts generally will enforce noncompetes, provided the terms don't last too long (usually not more than 18 months); aren't too broad (the industry definition must be narrow); or are not "secured" by payments above and beyond the regular salary/bonus structure. (These limits, by the way, may become less predictable with the pending retirement of respected judge Allan van Gestel from the Suffolk County business-litigation session at the end of this month.)

Spark also proposes that provisions restricting the use of nondisclosure agreements (NDAs) not be affected. Spark agrees that unauthorized disclosure of such information may be harmful to both the owner of the information and (presumably) the economy at large.

Proving a breach of an NDA or misappropriation of a trade secret is expensive, difficult, time-consuming, and occurs only in the most extreme cases (such as when the information is extremely valuable, the disclosure is egregious, or interpersonal issues are involved). Proof of a noncompete violation, in contrast, is relatively straightforward: Either the person is working for a prohibited competitor or not.

In any policy review of noncompetes, it is important to avoid throwing out the baby with the bathwater. For instance, when a privately held company is sold, it is normal for key managers and shareholders to be subject to a lengthy noncompete period, which enables the buyer to capitalize on its investment. Moreover, in severance agreements, noncompete periods sometimes allow parties to reach common ground: The former employee receives greater severance compensation, and the former employer is willing to pay more because it has received something of value -- knowing the former employee won't cross the street to work for a competitor. Both of these instances should be unaffected by a "reform" of noncompetes.

Spark's proposal attempts to address what academics consider a modern-age "tragedy of the commons" -- although each investor/employer believes he is acting in his own self-interest by causing employees to sign noncompetes, the result (according to the academics) is a worse outcome for society as a whole. (To its credit, Spark has unilaterally disarmed by stating it will not require its own portfolio company employees to enter into any more noncompetes.)

What the proposal may do is "spark" a discussion about the necessity and extent of noncompetes in the technology economy in Massachusetts. If the academic studies are correct, then perhaps it is appropriate to review these provisions, and consider whether we can find a way to encourage growth - while retaining the ability to use noncompetes in more limited areas.

Matthew T. Henshon is a partner at Boston law firm Henshon Parker Vyadro PC. He has no attorney-client relationship with anyone mentioned in this article. Firm partner Terry Klein contributed to this op-ed.