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Understanding the Law Regarding Non-Compete Agreements

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Q: "I just discovered that I hired an employee who is bound by a non-compete agreement with his former employer. What do I do now?"

Under Nevada law, a post-employment restrictive covenant -- sometimes referred to as a "non-compete agreement" -- is enforceable against a former employee if it is reasonable and not countered by a prevailing public policy. But in certain circumstances, such covenants can also be enforced against an individual's new employer. In other words, if a company hires a new employee and that employee is still bound by a restrictive covenant with his/her previous employer, the hiring company

could find itself named as a defendant in a lawsuit and subject to a preliminary injunction ordering the company not to engage in certain competitive acts that would violate the agreement.

Consider the following example: John Doe agrees with his employer, ABC, Inc., not to compete with or solicit any customers of ABC, Inc. for a period of two years after the end of his employment. John Doe quits his job at ABC, Inc. and starts working the following month for XYZ, Inc., a direct competitor of ABC, Inc. John Doe also begins soliciting customers he serviced at ABC, Inc. Under Nevada law, ABC, Inc. is entitled to enforce its agreement not only against John Doe but also, depending on the cir-

cumstances, against XYZ, Inc.

Many organizations are not aware of the perils of hiring a person who is bound by a restrictive covenant with his/her former employer. As the Nevada Supreme Court has explained, although not an actual party to a covenant not to compete, a party may nonetheless be enjoined if that party has knowledge of the covenant and breaches the covenant in active concert with the principal party to the covenant. [Las Vegas Novelty v. Fernandez, 106 Nev. 113, 116, 787 P.2d 772, 774 (1990)] Thus, in the previous example, XYZ, Inc. could be enjoined from breaching John Doe's covenant with ABC, Inc. if XYZ, Inc. is aware of the covenant and is acting in concert with John

Doe in its violation.

The rationale, according to our Supreme Court, is that “allowing a third party knowingly to aid and abet violations of a covenant not to compete entirely emasculates the covenant.” In adopting this rationale, the Nevada Supreme Court followed the majority view adopted by other states but also relied on the plain language of Nevada Rule of Civil Procedure 65(d), which states that an injunction or restraining order is binding upon the person against whom it is issued as well as “upon those persons in active concert or participation with them who receive actual notice of the order by personal service or otherwise.”

What does it mean for a third party to “act in concert” and with “knowledge” of the covenant? Although circumstances will differ from case to case, in Las Vegas Novelty, the Nevada Supreme Court found that the new employer was acting with knowledge of the covenant and in active con-

cert with the plaintiff’s former employee because among other things the former employee had been soliciting customers and his new employer was supplying merchandise to those customers.

The bottom line: just because you did not sign a restrictive covenant or non-compete agreement with a particular plaintiff does not mean you cannot be bound by its terms. Stated another way, a party to a restrictive covenant cannot do indirectly what he/she cannot do directly. To avoid circumvention of the restrictive covenant at issue in that case, Las Vegas Novelty stated that the plaintiff would be best protected by an injunction against both the plaintiff’s former employee as well as his new employer, which was not a party to the covenant.

Good hiring practices include verifying with prospective employees before hiring whether they have any agreements with restrictive covenants from a former employer. Some

prospective employees may not have kept or even received copies of such covenants or may not remember having signed such covenants. In industries where such covenants are prevalent, it would be prudent to check with the former employer at the time of hire to ensure there are no active covenants in force. For companies that have hired an individual and thereafter discover that their new employee is still bound by a restrictive covenant with a former employer, consult an attorney immediately. The attorney can advise the best course of action based on the particular terms of the restrictive covenant and the other facts and circumstances of the matter.