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LEGISLATIVE ALERT

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Arkansas General Assembly Passes Law Governing Non-Competition Agreements Between Employers and Employees

On March 26, 2015, the Arkansas General Assembly passed SB 998, which was subsequently signed into law by Governor Asa Hutchinson as Act No. 921 of 2015 (the "Act"). The Act stands to significantly increase the reliability and enforceability of non-competition, or non-compete, agreements between employers and their employees. Employers have traditionally used non-compete agreements independently or in conjunction with confidentiality agreements to protect trade secrets, customer lists, intellectual property and other confidential or proprietary information from being disclosed or used by a former employee within the same competitive market.

Historically, Arkansas courts have viewed non-compete agreements between employers and employees unfavorably and have struggled to provide consistent and predictable rules when judging the reasonableness of the restrictions imposed by a non-compete agreement. To compound the problem, Arkansas courts have previously rejected both the "blue pencil" and "reformation" doctrines. Blue-penciling allows a court to simply strike out the language it views as unreasonable, leaving the rest of the agreement intact. Reformation, the most popular approach states have taken with regard to non-compete agreements, permits a court to reform the agreement so as to make it enforceable according to its revised terms. Because non-compete agreements have been found to be enforceable or unenforceable in their entirety by Arkansas courts in the past, employers have often been uncertain regarding the validity and enforceability of their non-compete agreements with employees and former employees. As a result, many employers have been left more vulnerable to their competitors.

The new Act, to be codified as Section 4-70-207 of the Arkansas Code, has three major components.

- First, the statute enumerates categories of protectable business interests, the presence of which is a prerequisite to an enforceable non-compete agreement. Under the statute, protectable business interests include the following:
    - Trade secrets;
    - Intellectual property;
    - Customer lists;
    - Goodwill with customers;
    - Knowledge of business practices;
    - Methods;
    - Profit margins;
    - Costs;
    - Training and education; and

- A catchall provision that includes all other confidential or proprietary interests.

Where in the past Arkansas courts have inconsistently defined a protectable business interest, the statute adds certainty to that definition. That the statute specifically permits the protection of customer goodwill is significant, given that courts have not enforced the protection of customer relationships with much predictability.

- Second, the statute has incorporated the "reasonableness" test courts currently use when judging the enforceability of non-compete agreements, which considers (1) the nature of the protectable business interests; (2) the geographic scope of the employer's business and whether the geographic limitation is feasible; (3) whether the restriction is limited to a specific group of customers or entities associated with the business; and (4) the nature of the employer's business. Notably, the statutory test for determining reasonableness excludes the consideration of the restriction's duration. Rather, the statute provides that a post-termination restriction of 2 years is presumptively reasonable, unless clearly proven otherwise.

- Finally, what may prove most significant about the Act is the introduction of the reformation doctrine to non-compete agreements. Under this doctrine, as set forth in the Act, if a court determines the restrictions of a non-compete agreement are unreasonable, the court must modify or reform the offending or unreasonable terms to such terms that the court finds are appropriate and reasonable under the circumstances and enforce the contract under its reformed terms and conditions. While a majority of states have instituted the reformation doctrine in a manner that provides courts with the discretion to reform a non-compete agreement, Arkansas is now among only a few states that mandate court reformation of unenforceable language.

The Act represents a marked change in the way businesses can now approach the drafting of non-compete agreements. Given the former all-or-nothing stance of the Arkansas courts, businesses have often considered an inadequate restriction regarding protectable business interests to be better than the risk of no restriction at all, and many have drafted agreements that do not fully protect their interests. The addition of this statute, and particularly the adoption of the reformation doctrine, will now allow businesses to draft non-compete agreements without undue fear of complete unenforceability.

The full text of the Act can be found by clicking here.

Contacting Kutak Rock LLP

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