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Water Cooler Talk: Insights on Noncompetes From 'The Office'

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With the potential for a federal ban on the horizon and increasing restrictions on noncompete agreements at the state level, employers are becoming increasingly hesitant to look to noncompete provisions for protection, turning instead to confidentiality provisions and, in some cases, nonsolicitation of customers agreements.

But, contrary to popular opinions, there are tax reasons why certain C-suite executives may actually want a noncompete in place with their employer.

We explored the complex world of noncompetes, including associated tax issues, drawing parallels from "The Office," and its beloved and ridiculous cast of characters. We spoke with Constance Brewster and Jim Earle, two Troutman Pepper employee benefits and executive compensation-focused attorneys.

Q&A

Tracey Diamond: What is the main justification for companies wanting to have employees sign a noncompete?

Jim Earle: The point is to protect confidential company information in a practical way.

Evan Gibbs: What are some ways in which noncompetes come up in your practice?

Jim: In compensation programs, there are some tax rules that can come into play. There is something called 280G of the Internal Revenue Code that has to do with golden parachute payments where noncompetes might be a good thing for the employee.

Constance Brewster: A noncompete is a great tool for helping reduce the impact of 280G in connection with corporate transactions.

Generally, Section 280G of the Internal Revenue Code says that if your company undergoes a change in control, and your highly compensated employees, officers or directors who are disqualified individuals under the 280G rules receive parachute payments that exceed a certain threshold amount, it triggers a 20% excise tax on such disqualified individual and a loss of deduction for the corporation.

A noncompete can be helpful when you can allocate value to the noncompete and reduce a portion of the parachute payments that may otherwise exceed the threshold and trigger the 20% excise tax.

Evan: In “The Office,” Michael Scott left Dunder Mifflin to start his own paper company.

Dwight (picking up the phone): Dwight Schrute.

Michael: Hello, traitor.

Dwight: I think you have the wrong number, Michael.

Michael: I want you to listen to me. And I want you to listen to me good. I’m going to come at you hard. I’m going to steal all your clients and then I am going to kill them in front of you.

Pam: Michael!

Michael: Hear me, Dwight, when I say I brought you into this world and I can take you out.

Tracey: This is precisely the type of conduct that noncompete and nonsolicitation agreements are trying to protect against — the employee who leaves and takes the company’s customers with him. What has been your experience with clients faced with this situation or trying to prevent it?

Jim: Sometimes, in negotiating executive agreements, we’ll have an executive’s attorney argue that if there’s going to be a noncompete, then there needs to be a payment made during the noncompete period for the noncompete to be effective. And normally, you’re only going to get a payment post-employment if it’s been a termination without cause.

And my response to that is, “Hang on. The time we really want this is when the person quits, and we’re not paying them severance when they quit.”

Tracey: What are some issues or problems you have seen with companies trying to enforce these agreements?

Evan: For us, where employees live, where the company is headquartered, where the operations are, can play a huge role in our ability or our client’s abilities to enforce noncompete agreements.

Constance: The noncompete must be valid and enforceable for it to have value to reduce or mitigate against the 280G issue. In California, for example, we know that noncompetes are not enforceable, absent circumstances.

Tracey: Michael Scott successfully poached two other Dunder Mifflin employees to come work for his new company. I’ve seen where employee nonsolicitation provisions have been litigated.

Oftentimes, executives think that no one will be able to determine whether they take an employee with them, as opposed to the employee coming to the new company of his or her own volition.

Jim: A customary feature of compensation arrangements includes post-employment covenants, such as a nonsolicitation of employees provision. Those employee nonsolicitation covenants should be reviewed to see if they distinguish intentional affirmative solicitation versus an employee who chooses to come on their own accord.

Tracey: Those cases often implicate personal phone records, personal email accounts, Slack accounts and text messaging.

Evan: That’s where we get into the real juicy stuff.

Tracey: The difference between benefits lawyers and labor and employment lawyers.

Jim: There is also an important difference between a garden leave and a severance program when it comes to participation and benefit plans.

Constance: When considering garden leave — the common name for a period during which an employee, who is leaving the company, stays away from work but continues to receive their regular salary — it is important to determine if the leaver will be eligible to continue participating in any company equity, compensation and benefit plans.

For example, consider whether garden leave results in a loss of coverage and triggers Consolidated Omnibus Budget Reconciliation Act obligations under your group health plan. In many plans, it does.

Garden leave also triggers complex issues under Section 409A of the Internal Revenue Code for nonqualified deferred compensation, especially whether a separation from service that triggers a deferred compensation payment occurs at the beginning or end of the garden leave.

Conclusion

While certain types of restrictive covenants are less likely to be enforceable as the law continues to evolve, there remain incentives for both employers and employees to enter into provisions to take advantage of tax incentives and protect company assets.

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